Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON
BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 36

THURSDAY, JUNE 23rd, 1970

Thirtieth Proceedings on the Government White Paper, entitled:
"PROPOSALS FOR TAX REFORM"

WITNESSES:
(For list of witnesses see Minutes of Proceedings—Page 36 : 5)

APPENDICES:

"A"—Brief from the Toronto Stock Exchange.

"B"—Brief from the Independent Petroleum Association of Canada.

"C"—Brief from Denison Mines Limited.

"D"—Brief from Loram Limited.

"E"—Exhibits I, II and III as submitted by Texaco Canada Limited on June 10, 1970, Issue No. 31. (see Minutes of Proceedings, Page 36 : 5).

22265—1

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (*Rigaud*)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (*Ottawa West*)	Hays	White
Cook	Hollett	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

22265—1½

MINUTES OF PROCEEDINGS

TUESDAY, June 23rd, 1970.
(58)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Benidickson, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Gelinas, Hays, Isnor, Kinley, Phillips (*Rigaud*) and Welch—(14).

Present, but not of the Committee: The Honourable Senator Smith—(1).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

THE TORONTO STOCK EXCHANGE:

Mr. W. H. A. Thorburn, Chairman of the Board of Governors, TSE, (Mills Spence & Company Limited.);
Mr. J. R. Kimber, President; TSE;
Mr. J. B. Pitblado, Chairman, TSE White Paper Committee; (Harris & Partners Securities Ltd.);
Mr. D. G. Lawson, Vice-Chairman, Board of Governors, TSE, (Moss Lawson & Company Limited.);
Mr. J. P. Bunting, Member, TSE White Paper Committee; (Alfred Bunting & Company Limited.);
Mr. T. R. Bradbury, Member, TSE White Paper Committee; (Annett Partners Limited.);
Mr. J. Hutchinson, Member, TSE White Paper Committee; (Wood Gundy Securities Limited.);
Mr. W. L. Somerville, Executive Vice-President, TSE;
Mr. H. W. F. McKay, Vice-President, TSE.

INDEPENDENT PETROLEUM ASSOCIATION OF CANADA:

Mr. A. H. Ross, Director, First Vice-President;
Mr. B. Rombough, Chairman, Tax Council;
Mr. G. Roark, President;
Mr. H. Van Renssalear, Director.

At 12:30 p.m. the Committee adjourned.

AFTERNOON SITTING

2:15 p.m.
(59)

At 2:15 p.m. the Committee *resumed.*

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Benidickson, Burchill, Carter, Cook, Gelinas, Hays, Hollett, Isnor, Kinley, Lang, Molson, Phillips (*Rigaud*) and Welch—(15).

Present, but not of the Committee: The Honourable Senators Laird and Smith—(2).

WITNESSES:

DENISON MINES LIMITED:

Mr. S. B. Roman, Chairman of the Board and Chief Executive Officer;
Mr. E. B. McConkey, Vice-President, Finance & Treasurer;
Mr. W. A. MacDonald, Q.C., Partner, McMillan, Binch;
Mr. C. D. Parmelee, Executive Asst. to the Chairman of the Board;
Mr. P. Palmer, Assistant to Vice-President of Finance.

LORAM LIMITED:

Mr. F. P. Mannix, President;
Mr. E. Connelly, Vice-President;
Mr. W. R. Lord, Counsel.

Ordered: That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from the Toronto Stock Exchange.
B—Brief from the Independent Petroleum Association of Canada.
C—Brief from Denison Mines Limited.
D—Brief from Loram Limited.
E—Exhibits I, II and III as submitted by Texaco Canada Limited on June 10, 1970, Issue No. 31.

NOTE: Appendix E—Exhibits I, II and III were inadvertently omitted from the printing in Issue No. 31 dated June 10th, 1970 when Texaco Canada Limited appeared before the Committee.

At 4:55 p.m. the Committee adjourned to the Call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Tuesday, June 23, 1970

The Standing Senate Committee on Banking, Trade and Commerce met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Hon. Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, I call the meeting to order. The first submission that we will consider this morning is that of the Toronto Stock Exchange. Mr. Kimber will make an opening statement, after which he and his colleagues will answer our questions.

Mr. Kimber, will you introduce your panel?

Mr. J. R. Kimber, President, Toronto Stock Exchange: Mr. Chairman, and members of the committee, I believe you have a list of the people who are appearing this morning, but for the purposes of identification I will say that on my right is Mr. Bunting, who is a member of the Committee of the Toronto Stock Exchange appointed to study the White Paper, and also a member of the Board of Governors; on his right is Mr. Thorburn, who is the Chairman of the Board of Governors of the Toronto Stock Exchange. Both of these gentlemen are brokers. As perhaps you know, I am not a broker, but an outsider, so that when we get down to the technical questions I shall turn them over to those gentlemen.

I shall try to make my opening remarks reasonably brief. Perhaps I could start off with a statement of our basic philosophy—the philosophy that we adopted in approaching a study of the White Paper. We accept, of course, the objectives set out in paragraph 1.6 of that document, but we place greater emphasis on some of those objectives than others. It can simply be said that we place more emphasis on long term equity as contrasted to short term equity. We place relatively greater weight on the saver as contrasted to the consumer. We feel that the creator is more important to our society than the conserver. We submit that capital in itself is a social force, and that it must be used efficiently. We also argue that growth is important for the attainment of our nation's goals, both economic and social, and here I am referring to such goals as higher employment, a more equitable distribution of national income, and the Canadianization of our industry.

While we argue against many of the proposals in the White Paper, we do so within that context. We do not attack it on the grounds that it is a socialistic document, nor do we say it is completely illogical. We recognize that the draftsmen have made a sincere attempt to reform our tax laws, and that the White Paper contains a great deal of logic. We trust that our submission may have those same merits.

We approached this problem not as individual brokers, but on the ground that we are brokers and that we have some expertise, or should have some expertise, in the capital market. We felt we could best serve the process of discussion by directing our thoughts to the problems or benefits which might flow from the White Paper in connection with the capital market. We point out that our market has certain characteristics, and included in those characteristics is a lack of liquidity. That means that it lacks breadth and depth. We submit that this is a constraint on our capital market which has not been recognized—

Senator Phillips (Rigaud): I am sorry, but I missed that, Mr. Kimber.

Mr. Kimber: I am referring to the fact that the market has a lack of liquidity, a lack of breadth and depth. By that I mean that there is a large number of our listed companies with relatively few shares in the hands of the public. Also there is a limited number of investment vehicles available to the investing public. This constraint in our capital market, we feel, has not been recognized in the White Paper.

With these basic points in mind we have made a number of major submissions. I know,

gentlemen, that you have heard some or perhaps most of these points before.

We say that the proposed integration of corporate and personal income should not be adopted. In place of the White Paper proposal we recommend a modified dividend received credit.

We do accept the concept that there be a capital gains tax, but at a rate lower than that proposed in the White Paper. Specifically, our recommendation is that one-third of a capital gain be taken into income.

We recommend that in connection with the capital gains tax the taxpayer have the option of a roll-over account. I hope that later on I might develop that further. We say that there should be no deemed realization on a periodic basis, the five-year revaluation. We do not think that this is appropriate. We make a major submission that the distinction between the widely-held companies and the closely-held companies and the resultant discriminatory difference in tax treatment be abandoned.

These points are we feel consistent with our philosophy. They are each related one to the other. For example, we think that integration is of benefit only to shareholders of dividend-taxpaying companies and will encourage investment of that type of company. These types of companies have less difficulty in raising capital.

This benefit to the mature companies creates a bias against the newer, growth oriented companies who are not in a position to pay dividends. The capital gains tax has the same bias. Both these biases are contrary to our concept that growth is important and that regard for the future is important more than concern for the past. Therefore we recommend a less generous dividend tax credit policy and a less onerous capital gains tax.

Our recommendation on integration would produce more revenue for the Government. We say that the additional revenue which the Government receives should be used to reduce the capital gains tax.

We recognize that the existing flat dividend tax credit can be objected to on the grounds of lack of equity. Therefore we recommend a sliding scale with a bigger tax credit to the small income earner and a lower tax credit to the large income earner.

We suggest a sliding scale between 15 per cent and 25 per cent instead of the present flat 20 per cent rate.

Since integration is of no benefit to non-resident shareholders and the capital gains tax is no penalty to them, it makes the growth securities more appealing to the non-resident than to the Canadian resident. We feel that this is a misdirection of our investment dollars and the attraction to the foreign investor in the wrong manner.

We say that the five year revaluation is again prejudicial to Canadian investors and Canadian companies. The proposals are in our view biased in favour of the closely-held company. This leads to some undesirable results in our view, such as slower growth and fewer investment vehicles for Canadian investors. It makes private companies more susceptible to foreign take-overs and deters them from going public.

We recognize that the White Paper introduced the five year revaluation partly as a cure for the lack of liquidity in the Canadian market. However, since in our view it cannot stand, there is no relief whatsoever in the White Paper against the locking-in effect created by a capital gains tax. Therefore, as a means of relieving against this locking-in effect, we recommend an optional roll-over approach to the taxation of capital gains. We submit that the economic benefits which flow from the efficient use of capital under this concept, plus the increased revenue it will produce, warrants that it be given serious consideration.

Under this approach an investor may move from one investment to another and defer his capital gain. He would pay it only when he took money out of the roll-over account for consumption purposes. We think that this freedom of movement of capital is most important for our economy.

The Chairman: Do you mean that there would be a capital pool?

Mr. Kimber: Yes, an investment account would be created. As long as the money remained invested the capital gains tax would be deferred.

Senator Beaubien: Do you not think, Mr. Kimber, that this would result in a difficult accounting procedure for the ordinary citizen?

Mr. Kimber: We have considered this, Mr. Senator, and have come to the conclusion that it is really not that difficult a problem. We have had people prepare these accounts and Mr. Bunting has given thought to this aspect.

Mr. J. P. Bunting, Member, Toronto Stock Exchange White Paper Committee: Yes, sir.

We have worked it out and set up schedules to see whether or not it would be difficult. It is not at all difficult to set up an account such as this on very simple bookkeeping methods. With regard to the specific type of securities included in such an account, we stay within what we consider to be the area of our own expertise. Therefore, we discuss stocks, bonds and mortgages, concerning which there would be no particular problem.

In addition, many brokers are now changing over to computers, which allow them to keep their clients' accounts. In our own operation, for instance, within two minutes I can run out a client's account at any time. Therefore, if valuation day were declared today I could give all our clients their positions very quickly.

Senator Beaubien: I can see that a man with a certain amount of money, a broker looking after him, a good account and a tax lawyer and a few other things can get by. However, how about the ordinary man who has a few shares here and there and none of these facilities?

Mr. Bunting: There would be no particular problem in stating the value at the beginning and end of the period.

Senator Beaubien: There would be transactions in between.

Mr. Kimber: They would be recorded throughout the year. There would be an opening account with his return of one year, then a closing and a new statement at the end of that year.

In view of the constraints in our market and our desire to use capital efficiently it is our strong recommendation that this type of account should be given serious consideration.

One of the appendices to our brief indicates that not only does the investor benefit from this by using his money more efficiently but in the end result the Government receives more revenue. It is nice to be able to satisfy both sides of the fence at the same time.

The Chairman: As an illustration, suppose you are opening an account for Mr. X. It shows that he invested $5,000 in securities. When the account is closed out at the end of the year the client may have securities with a market value of $7,500.

Do you then automatically assume that the $2,500 is a capital gain and as long as it is represented by investment in securities it is a roll-over?

Mr. Kimber: That is right.

The Chairman: It is only when he removes the capital gain element. Then, let us say, you run into a year when he has capital losses and in the process starts all over again.

Mr. Kimber: He may gain $2,500 in year one, in year two he may lose $2,000 of that, so at the start of year three he would have a carry forward capital gain of $500.

The Chairman: Then in the rollover process in that fashion, in two years in succession, whether the rollover applied or not, he would achieve the same thing under the White Paper so as to set off his losses against his gains.

Mr. Kimber: Yes. He may not have made the transfers in year one that realized the capital gain of $2,500, because of the locking in effect of the capital gains tax. We would suggest that if he drew some money out of this account, to buy this proverbial fur coat that the wife always seems to be expecting but never receiving, that would be deemed a withdrawal against the capital gain, so when he drew that money out it would be taxed as part of his income.

Senator Beaubien: Suppose the account had been running for five years. He would have started in 1965; he may have had a small profit, in and out, and he has a big loss today. Can he draw some money out and take off the loss against his other income? If he has a big loss, to get any benefit from having had that loss does he have to draw some money out?

Mr. Kimber: If he wanted to take credit for the loss he would have to draw money out.

Senator Beaubien: Could he take the money out, take credit for the loss and put it in a mortgage instead of having it in stocks? Suppose over the last year I had a $10,000 loss, so I want to take that credit against my income. Can I draw out a certain amount of money, sell securities, take that loss, so that I really recoup most of it, and then take the $10,000, or whatever I take out, and put that into a mortgage?

Mr. Bunting: A mortgage would be part of the rollover account, sir.

Senator Beaubien: So I would not get the benefit. What could I do with the $10,000 to have my cake and eat it too?

Mr. W. H. A. Thorburn, Chairman of the Board of Governors, the Toronto Stock Exchange: I think it is difficult. It seems that we cannot have our cake and eat it too. One makes a decision whether or not to operate a rollover account, or whether to accept capital gains or capital losses as they occur. Our endeavour here is to encourage people to maintain their capital in productive enterprises.

Senator Beaubien: But if you have a loss and want to get a benefit from it, if you withdraw some money from the account you can take the loss, can you?

Mr. Bunting: If you never made a gain, then you can draw—

Senator Beaubien: I suppose there would be an overall loss.

Mr. Bunting: Then you can withdraw the capital. If you have a capital gain in the account, you would pay the capital gain immediately upon withdrawal. If you have never made a gain, there is no—

Senator Beaubien: But if you made a loss?

Mr. Bunting: If you made a loss you can take it against income, exactly as in the White Paper.

The Chairman: Then you support the capital gains tax where losses are not necessarily tied into gains, and can only be written off against gains. You believe losses can be written off against earned income?

Mr. Bunting: We give you an option here. If you take the straight realization approach—in other words, simply assume there is no five-year revaluation—if you sell something and make a capital gain, then it would be directly against that. If you take a loss it could be against income. That is what they say. On the other hand, if it is in the account, if you never make a gain, then it could be a loss against income. But if you make a gain at any point in that account and then take a loss, it is against the gain.

Senator Beaubien: Suppose I put some money in and I have a loss of $10,000 and I take out the money I had in the account. I write off the $10,000 against my income so I get most of it back. I take the money I took out, and suppose I just leave it on short-term notes, or something like that. Can I do that?

Mr. Bunting: If you put it into short-term notes it would still be in your account.

Senator Beaubien: All right, then I will leave it in the bank. If I leave it in the bank and the bank gives me 6 per cent interest, can I do that? If you can do that you will be driving a great many people out of the market every time the market goes down, and it is stale.

Mr. Bunting: The real point of the rollover account is that with the realization approach you always have to be considering the tax you pay whenever you buy a new security. In other words, you have to say to yourself, "If I sell this and pay the tax how much more would that other one have to pay me to make it worth while shifting my money to that security?" We are trying to make an approach where money will move as quickly as possible to the best possible spot, without having to make that kind of decision. It is an option. We suggest that it be an option, that a person can decide to go into a rollover account or simply stay on a realization basis and pay their taxes as they sell. It is strictly an option.

Mr. Kimber: This is the same result; the proposition you put forward has the same result as the White Paper, and must surely be a concern to the revenue people. In the United States we have a great splurge of year-end selling to create losses so that it can be wiped off against income.

Senator Beaubien: But they buy something else, so it is good for the broker.

Mr. Kimber: They buy the same security on some kind of a buy back arrangement, so you get this pressure on the market, which is not particularly healthy, so people can get out.

Senator Beaubien: If the market is down it is not healthy, but it is good for the brokerage business.

Mr. Kimber: May I comment on that? I suppose everybody has some vested interest in some part of our life, economic or otherwise. We come here to try to be impartial, but certain things that we recommend would, I suppose, have benefits to brokers. However, we are trying hard not to put them forward for that reason, but for the overall economic benefit.

Senator Connolly (Ottawa West): You have no need to worry about that.

Mr. Kimber: Thank you, senator.

Senator Phillips (Rigaud): I was about to say that we are not interested solely in the vested interest. We are interested in a tax structure that will suit everybody, including the best.

I find your approach somewhat confusing. You damn the White Paper with faint praise, and then end up by not accepting the integration system. You go back to a capital gains tax, which is contrary to the general attitude that has been reflected here of having a flat rate, but you want a third of the profit included in taxable income. What I find interesting is the variation of the tax credit to fit in with the lower brackets as against the higher brackets.

Having in chapter three definitely come out against the integration system and said that there are many items in the White Paper that are worthy of praise, would you indicate what other aspects of the White Paper this committee might well support in its recommendations? Because I do not think you deal with them. Your emphasis, which is proper, is in relationship to capital accumulation in regard to your activities. You emphasize generally savings as gains expenditure, and all that sort of thing, and the economic sphere. Having abandoned the integration system and having dealt specifically with a proposed treatment of capital gains and dividends tax credits as well as partially praising the White Paper as containing some equitable aspects requiring consideration, what equitable aspects in the White Paper do you think require current attention by this committee by way of support?

Mr. Kimber: I will limit my remarks to the capital market situation. We could personally have comments on higher exemptions, and so on on, with which I think we would agree. But they are not really capital market problems. We think that in today's climate in Canada there should be some form of capital gains tax. I think that Mr. Benson may feel he has accomplished a lot through the process of now having wide general acceptance by the business community.

Senator Phillips (Rigaud): I am not directing my question to that. You have dealt, in my opinion, ably and clearly with your proposed treatment of the capital gains and the indictment of the integration system. You have also given us proposed revisions in the treatment of the present dividend tax credit. As spokesman for this important institution have you any other observations to make for the guidance of this committee on the overall economic picture from the point of view of proposed recommendations in the White Paper, or is that something you feel should be left to the taxpayers and you have just decided not to deal with it, which I think we will understand if that is the case?

Mr. Kimber: In areas outside the capital market we have refrained from commenting on that. One other point which I think is related to the capital market, although on the fringe of it, is the $35,000 figure. We do not feel that that benefit should be given to the large corporation. We feel it is equitable and they do not need it. When we speak of the small corporations the same argument might be made for small businesses. We accept the Carter definition of small corporations, and we feel that they should still have some tax incentives.

Senator Phillips (Rigaud): Do you accept the definition from the point of view, not necessarily of what is a small corporation but that they should get special tax relief? Is that what you mean or do you accept the Carter definition of what is a small business?

Mr. Kimber: We accept the definition of what is a small business.

Senator Phillips (Rigaud): What is your definition of a small business?

Mr. Kimber: Three million dollars gross revenue or $1 million assets. That was the Carter definition.

Senator Phillips (Rigaud): You like that as a definition of a small business?

Senator Cook: It is $10 million. The gross revenue is not less than $10 million.

Mr. Kimber: Thank you, Mr. Senator. We saw no reason to quarrel with that. That is a figure which could be discussed in more detail. That is what the Carter Commission adopted and it seemed to us to be reasonable. Companies below that size, as you know, have difficulty in coming to the formal capital market to obtain capital. They do not have the facilities that the larger companies have and therefore they need some other means of generating capital.

Senator Phillips (Rigaud): I think it is very comforting that you, in line with big business and who are representing a good many of them, take the position that the bigger companies do not need the lower tax credit. Imperial Oil took that position as well.

As a result of my questioning I have elicited a conclusion that small businesses should receive a lower rate of taxation. I will come back to capital gains in a moment and a dividend tax credit which is the main thrust of your brief. Have you any other suggestions under the White Paper?

Mr. Kimber: Those are all the points we discussed.

Senator Phillips (Rigaud): I will come back to one question with respect to capital gains. You have made your recommendation and whether one agrees is beside the point for a moment, because we are here to listen. You have dealt with the question, as have many others, that the capital gains tax should be related in some form in terms of equity to estate taxation. How do you propose to bring that about when there is a jurisdictional disagreement between the provinces and the federal Government as to who should have the right to impose an estate tax? Until there is agreement between the federal and the provincial governments on the subject matter, how can you possibly come up with a suggestion as to how we can get a reasonable synthesis between capital gains tax and estate taxes?

Mr. Kimber: That is a problem which I think is even wider than the way you put it. I cannot quote the White Paper as being acceptable or workable.

Senator Phillips (Rigaud): It should be dependent upon concurrence with the views of the provinces. In view of the fact that there is no such agreement, how can we possibly deal with the subject matter of capital gains synthesis, as I call it, in the light of the parent disagreements which were reflected in reports from two provincial governments in the Winnipeg Conference a couple of weeks ago?

Mr. Kimber: In my view and perhaps it is a personal one, I think an agrement is essential, but sitting on this side of the table all we can do is make an assumption that an agreement will be worked out.

Senator Phillips (Rigaud): Did you say so in your brief? I have not found it in your brief.

Mr. Kimber: We did not comment on that aspect of it. The total tax picture that a corporation has to pay is what concerns the capital market. The investor does not concern himself with whether 50 per cent of the tax is going to the province and 50 per cent to the federal Government and 75 and 25. In so far as his investment dollar is concerned, he wants to know what the net picture is going to be.

Senator Phillips (Rigaud): Is it fair to supplement your recommendations in respect to capital gains by the statement that the imposition of a capital gains tax should be conditional upon a concurrent working out of the problem of estate taxes with the provinces?

Mr. Kimber: Yes.

Senator Phillips (Rigaud): You would say that?

Mr. Kimber: Yes, sir.

Senator Cook: You say in paragraph 4, page 28...

Mr. Kimber: We say that the capital gains tax and estate laws must be worked out jointly. I do not think that I could claim that I was directing this paragraph toward the question raised by Senator Phillips. I do agree with the question, and the answer is yes.

Senator Beaubien: Mr. Kimber, you come out and say you do not think we should have capital gains. Have you a fairly good idea of what class of taxpayer the burden would fall on of capital gains? Have you studied that to some extent?

Mr. Kimber: I would ask that Mr. Bunting answer that question.

Mr. Bunting: As a general statement, it is a fair statement that the wealthier you are, certainly with the realization approach, the less capital gains you will probably have, because you tend to have large blocks of securities which may be related to corporations with which you are personally associated, that roll on through the years.

As brokers, we recognize that the smaller the account the more aggressive the person tends to be. I do not think there have been any studies done on this by a university professor or anything like that; but we know, from our experience, that the smaller the account, they always think they can build it up and they always work to build it up, while the bigger account goes rolling along. So in the case of an equity point of view you might say the burden is with the smaller investor rather than on the very large investor, particularly with the realization approach.

Senator Benidickson: And, from the point of view of the income taxpayer, you may say that the bulk would be—you may have your own description—what we have been discussing as the "middle income taxpayer".

Mr. Bunting: Yes.

Senator Beaubien: Mr. Bunting, to follow up that middle income taxpayer, from the studies we have made, he is already paying 30 per cent more in income tax than the equivalent American. So it is surprising that you would suggest that we start a new type of tax—when our people are already taxed a good deal more than the American. That is what surprises me, that you suggest we have a capital gains tax, a definite suggestion that we have one. I do not see any equity in that suggestion.

Mr. Bunting: I suggest the argument would be that there is no equity in loading it on to the fellow who is already carrying it. There is a feeling abroad in the land that it is inequitable that some people make gains and have additional purchasing power on which they do not pay tax. We, I guess, accept that feeling and, as a consequence, tried to figure out how we could recommend a system which would be less damaging to the capital market.

Senator Cook: Would it be fair to say that, with the extra expertise of the income tax collector and with the development of jurisprudence, less and less capital gains are escaping tax, in these days?

Mr. Bunting: Absolutely.

Mr. Kimber: That is true. There is the great concern people have shown about the land speculator who makes the capital gain. I think that people who practise law, especially in a city like Toronto, know that that just does not happen any more.

The Chairman: It has not happened for some time.

Senator Beaubien: I cannot understand the Toronto Stock Exchange making the recommendation based on the point that people are escaping something.

The Chairman: Except, Senator Beaubien, there might be this way of looking at it. There will always be some people who will make capital gains; and capital gains are looked on as another source of income for the tax collector. The point you are making, senator, is a good point—that is, that there may be a group that you would ordinarily expect is the group that would participate in the production of capital gains, but the taxation system is such, or is supposed to be such, that they will not have the capacity to do it.

As I understand Mr. Bunting, all he is saying is that, to the extent that there is capital gain it is a source of income, "another source of income, and therefore we support the theory".

My own view at the moment is that the capital gain consideration has got beyond the stage of economics, or where you levy tax, and has got into a political area where the public is convinced that it is a source of income and that something should be done about taxing it.

Senator Cook: Would it be fair to say that the witness is accepting it, but not advocating it?

The Chairman: Yes.

Senator Beaubien: The witness did not say that.

Mr. Kimber: In appropriate cases—perhaps in many cases—there may be a capital gain. In this, I am going a long way along the road, for the president of a stock exchange.

We have thought that people should be encouraged to get into the savings stream, and that there should be tax incentives for the small income person, more than exists in the retirement pension plan, and so on. Because we feel that saving is a good old fashioned virtue, we still believe in that, and we think the country needs more capital, particularly if we want to Canadianize our industry, which we think is a good thing to practice. But for the small investor or the small saver there should be some advantage given to him. We do not set out what that should be, but we think it should be along the same lines as the retirement savings plan or things of that nature, so that he would not be paying capital gain as a small investor.

Senator Phillips (Rigaud): Mr. Kimber, I would like to put this question to you and your colleagues. I think the general import of the point you touched on, and that the chairman touched on, is that there is a feeling that possibly we should have a capital gains tax. But there also is a stronger feeling against "deemed to be" taxation on valuation that is not related to realization—to meet the objection we are all struggling with, business rollovers and that sort of thing—which creates

complicated problems. Have you given consideration to the feeling I had, which has gone through my mind at least, that we introduce the necessity of capitalizing undistributed unearned income, particularly in holding companies, when such unearned income is not needed for the normal purpose of carrying on the business. In fact, going back to the old section 13 of the so-called Income (War Tax) Act, which gave the minister the right to cause distribution to be made, or failing which there would be deemed to be distribution.

We have that in a section of the law, in section 105, where there can be a flat rate and you can capitalize surpluses. It would appear to me to be more desirable that we introduce the provision that, at the end of every five years, undistributed unearned income in holding companies be subject to capitalization under our present section 105; and in that way bring about a tax resultant by way of revenue to the Government. And we avoid the concentration of undue capital in too few hands.

That seems to be a much more reasonable approach, rather than worrying about things like roll-overs and the like. I think that in respect to capital gains, if we merely said that the tax is applicable, whether it be a flat rate or one-third brought into income, as you suggest, we still have to deal with problems of accumulations of income on an inequitable basis, as distinct from a capital gains tax.

Could I get your reaction to that idea?

Mr. Thorburn: Would this necessitate a definition of the use of the capital, senator? In your view, would one be justified by saying that this is for some special purpose?

Senator Phillips (Rigaud): No, we would just take the position that we are not playing around with commercial companies, industrial companies, manufacturing companies, and getting involved in ministerial discretions as to whether these moneys are needed, but just dealing with holding companies...

Senator Benidickson: May I ask our eminent corporation lawyer, whom I respect so much, what is a holding company? Is it defined in the Income Tax Act?

Senator Phillips (Rigaud): Yes. I would define a holding company as being the reverse of what I said to be an exempt company, a company that is not engaged in commercial or industrial manufacturing operations.

Senator Benidickson: I would say a holding company could be a parent company that holds resources rather than distributing its surplus for the purpose of financing, when required, its subsidiary.

Senator Phillips (Rigaud): First of all, Senator Benidickson, I will try to answer your question: what is a holding company?

I am directing myself to the question of concentration of savings which have not been the subject of tax beyond the original corporate tax because of the exempt income. I am speaking of exempt income from one Canadian company to another or from income coming in from foreign sources on the 25 per cent equity holding rule.

It would appear to me that it would be more logical to deal with the subject matter of constructive distribution of surplus on the payment of a flat rate which, after all, would not be too great whether it be 50 per cent or any other way under section 105 and, in that way, meet public criticism of undue concentration of capital in terms of yield which have not been subjected to taxes.

That strikes me as a more effective answer to integration than any other way.

Mr. Bunting: We did not specifically state what you are saying because it seemed to be an unreasonable idea in that specific case although I agree with Senator Benidickson. You have to wonder why the money is being kept. You might get into some sort of trouble, I would imagine.

Senator Phillips (Rigaud): The money is usually kept so as to make more money on it.

Mr. Thorburn: It would be a deterrent to re-employ this money such as in the far north area where it may be successfully employed in development.

Senator Phillips (Rigaud): That is exactly my point. In the payment of a flat rate you get the wealth in Canada capitalized, and maybe it can be used for investment, and you get incentives for expansion. In that way you have better equilibrium between foreign capital coming into the country, I would say.

Mr. Thorburn: It would continue to hold.

The Chairman: There would only be a constructive payout.

Mr. Thorburn: A constructive payout, yes.

The Chairman: That is the 15 per cent.

Senator Phillips (Rigaud): Yes. If we are going to get 15 per cent we would have to pay out grants. Here it is simply a flat rate where the revenue gets money and you create a huge reservoir of capital for investment.

The Chairman: You have done it in relation to actual funds and not as a deemed realization?

Senator Phillips (Rigaud): Exactly. You are now dealing with the position where earned surpluses bear no relationship to liquidity, but on the holding company it does.

Senator Connolly (Ottawa West): Mr. Chairman, I think the gentlemen of the stock exchange can be asked the other question, because I think they are in a rather objective position. We have had a good deal of discussion here on extractive industries such as the mining industry and the oil industry. They take a very dim view of the withdrawal of the incentives they have enjoyed. They feel that if the provisions of the White Paper prevail their industries will be very adversely affected to the point where they will go elsewhere and there will not be the development particularly in the remote areas of Canada through private auspices that would obtain under the present law.

I am thinking particularly of the three-year exemption and the depletion; and at the other end of the depletion system, as a principle it should be maintained in the Income Tax Act.

Now, from the point of view of the investing public in Canada, would you care to express any views about the criticisms they have offered, not specifically but about the general questions they have expressed on that point?

Mr. Bunting: Senator, we think that we do generally agree here, without getting into specifics, with the argument that is being made by the mining companies. We particularly feel that the question of regional development is an important one and that you can create a situation of neutrality so that you know, in fact, where money will not go.

There has been an incentive built into our original system for companies to go there. We feel, as an exchange, and as stated here, that it would be unfortunate if that incentive in some reasonable form is not maintained.

Senator Connolly (Ottawa West): Are you talking particularly about unearned depletion?

Mr. Bunting: I do not think we want to go into specifics, but there is one point in what you are saying that I would like to go into which relates to the shareholder of the company. What is happening now under the integration scheme and what affects regional development is that the incentive is given at the corporate level for the company to go into one of these areas and the company pays a lower tax rate.

It turns around at the shareholder level, because the company has paid a lower tax rate, and grosses up so that the effect is less. In essence, you take away at the shareholder level the incentive you intended to give at the corporate level.

We feel very strongly that this is a mistake and that it tends to offset the purpose; that is the point we made earlier. We agree with many of the things that they are trying to accomplish. Here is a case where, for technical reasons, what they suggest actually works against what they are trying to accomplish.

Mr. Thorburn: If I may elaborate a bit, it seems anomalous to us, sir, that our provincial and central governments provide incentives for plants to be developed in isolated areas or redeveloped areas by offering substantial amounts of capital—very, very large amounts in toto—and yet these plants must be operated by people who have a real incentive to contribute some of their own capital and match it up in part with capital from the public sector.

At the same time, we are keeping him interested in growing and expanding, but we withdraw some of the incentives from what comes out at the end of the pipe. Therefore we sort of give in one way to encourage it, and we reduce the encouragement in another.

In particular with a major deficit in our capital existing, it is essential in our view that the incentive be very strong for him to use his capital and work as hard as he can to increase it so that he may provide a better background for utilization of manpower which would result in a larger capital base down the road.

Senator Connolly (Ottawa West): Would you agree generally with the proposition that an incentive is more effective if it is given to the private sector through the Income Tax Act than if it is given to the private sector by way of grants, such as you describe through regional and economic expansion.

Mr. Thorburn: I would say, sir, that the assistance that comes from governments is essentially because of a lack of sufficient capital in the private sector to instigate plants or developments of this kind at the grass roots stage. I think a combination of the two is essential. The operator must still be deeply involved to make it work, but you cannot do that without a combination of capital from both sources.

The Chairman: But, Mr. Thorburn, the difference between giving a subsidy and providing an incentive in connection with earnings—where you can keep a part of your earnings free of tax—seems to me to be a very simple one. If the Government gives a subsidy, they have to raise the money from some place, so everybody else is paying for it. On the other hand, if they give a tax holiday or a depletion allowance, the company has to earn it, or it is not worth while. So, in the private sector, if you give them an incentive, they must earn it. Now, under the present law, if they do not earn enough to take depletion, they just do not have it and they do not carry it forward. It is gone forever. The history of many of the oil companies has been that they have not been able to earn enough to use the depletion allowance. The Hudson's Bay people told us that 1969 was the first year in which they earned enough to take the depletion allowance. If it were a subsidy, of course, the money would be going in in any event and the rest of the taxpayers would be providing that money. So it seems to me that the incentive in this form is a much better way of doing it.

Mr. Thorburn: Yes.

Senator Connolly (Ottawa West): Would you agree it is a much more efficient way?

Mr. Thorburn: Yes, I would.

Senator Cook: On this point of regional development, Mr. Chairman, which is mentioned on page 47, you say:

> In addition to attracting substantial quantities of capital to Canada, these extractive industries have made an enormous contribution to opening up previously undeveloped sections of Canada.

I wonder if one of the witnesses would care to indicate what some of these sections are.

Mr. Bunting: Certainly; you can look at the Northwest Territories near Whitehorse and the new Imperial Mines up there, and also in northern British Columbia.

Senator Cook: I think this is very important on the economic effect if it is correct. So, what areas and what companies do you include in this comment about having made enormous contributions to opening up previously undeveloped sections of Canada?

Mr. Bunting: Well, taking northern Manitoba, we can specifically mention the big nickel mine—International Nickel—and Sheritt Gordon's for one. Then there is the Thompson Mine of International Nickel. Both of those are well up and away from the general areas of population. Then you can take the new Imperial Mine up north of Whitehorse.

Senator Connolly (Ottawa West): Why don't you take one in Newfoundland and make Senator Cook happy?

Mr. Bunting: I am trying to. You can take the new mine in Newfoundland. There is just a whole series right across the country.

The Chairman: Not forgetting the Labrador development.

Mr. Bunting: Yes, the Labrador development—the iron ore.

Senator Cook: And the copper mine?

Mr. Bunting: This is an interesting question. There is much more in the heartland that is still a developmental situation.

The Chairman: And the tar sands in Alberta?

Mr. Bunting: Yes, the tar sands which have never made any money.

Mr. Thorburn: The pulp and paper companies in New Brunswick are a good example.

Mr. Kimber: I think you can go to almost every province in Canada and pick out examples where new areas have been developed by mining and oil companies.

Senator Phillips (Rigaud): Fortunately, having mentioned Newfoundland, you do not have to proceed any further.

I am going back to the dividend tax credit because your claim there intrigues me, and I quote from page 22:

> We recommend the adoption of a graduated dividend-received credit with rates ranging from, say, 25% for low-income investors, to possibly 15% for high-income investors. Such a credit would cost the Treasury approximately

the same as the existing 20% credit and be substantially less costly in terms of revenue loss than would be the relief proposed in the White Paper.

My question is this; have you any evidence that prompts you to say that the cost to the Treasury, under the present plan, would be approximately equal to the present 20 per cent tax credit, or is that a general expression of opinion?

Mr. Bunting: We specifically worked it out. Our economists worked it out that it would in fact be equal to the present system and would cost $200 million less than integration and that is why we suggested the $200 million.

Senator Phillips (Rigaud): Do you have that study?

Mr. Bunting: We could make it available, sir.

Senator Phillips (Rigaud): I would like, Mr. Chairman, that when it is received it should form part of this presentation with the permission of the gentlemen here.

The Chairman: Is it agreed, honourable senators?

Hon. Senators: Agreed.

Senator Hays: I would like to ask a question, Mr. Chairman, but first I would like to make an observation. It has taken Canada about 400 years to reach $43 billion of gross national product, and in the last ten years, we have almost doubled that; we lie about fourth or fifth in exports in a competing world and we are second so far as the standard of living is concerned. For the last two years, if the predictions of the Minister are correct, the federal Government will have had two surplus budgets. Therefore, would you suggest that this is the time to rock the boat, when Canada is in this position? Would you sooner live with the old tax system or would you sooner try out some of the things you advocate as being good in the White Paper?

Mr. Bunting: Well, one of the interesting things in the exercise we have just gone through is that we started, I believe, with a relatively open mind and we said we were going to be constructive and look at this thing to make the system work. But, surprisingly—at least to us—after looking through it, we came to the conclusion that the system we already have, which had developed by bits and pieces throughout the years and, I guess, was designed to encourage growth because Canada was not a growing nation—it increasingly looked like a pretty good tax system. Now this was not the thought we had at the beginning; we simply did not know. We thought it was probably a hodge podge. However, we do think that there can be modifications made to the current tax system such as the sliding scale on the dividend credit which creates a slightly more equitable situation. We do think that there are a number of things of this sort that can be done which, in essence, make our current system more equitable. We would not object to that, but we do feel very strongly that we should not overnight try to implement a system that would upset people, rightly or wrongly, because many people get upset without really knowing the facts of the situation. The only fact that you are sure of is that they are upset, and this affects their economic decisions. So, we recommend in here that we go forward carefully and that we do things by stages.

Senator Hays: You think there should be some slight changes?

Mr. Bunting: Yes.

Senator Hays: But do you think in the next ten years, under the proposals of the White Paper, that Canada will again double her Gross National Product and will be as competitive in the export field?

Mr. Bunting: The figures that I have seen, and that perhaps you have seen, indicate that the rate of savings could conceivably drop by rather frightening figures. If this is the case, one would assume that Canadian consumption would increase and that our savings would decrease. We would have to get the capital from somewhere. The possibility we would not be able to get foreign capital in the next few years quite as easily as we have in the past is very great, and the fact there is the high probability we would not be able to accomplish as much as we have. But, in fact, a careful reading of the figures also indicates that Canada has not gone forward in the last few years as quickly as many other countries.

Senator Hays: What countries?

Mr. Bunting: Well, take Japan. It has a personal savings rate of 20 per cent. We feel very strongly that there is a correlation between such a savings rate and the fantastic rate of growth of that economy.

Senator Hays: Would you prefer to have that sort of standard of living?

Mr. Bunting: I think it is a fair statement that the Japanese standard of living has improved very greatly since the war, despite the fact that they have been willing to save a lot to achieve things. They have a national mentality which is quite different from ours, and we are never going to be able to get people to do what the Japanese are doing; but we certainly do not want to bias the system so that we are nowhere near doing what the Japanese are doing.

What we, in essence, are saying in our brief is that we feel that the White Paper biases the system too greatly against savings, and we want to encourage Canadians to invest in growth type companies. This is why we are against integration and in favour of a dividend credit, because the integration proposal pushes us into buying companies from the past, into buying back the past, whereas what we really want to do is have people buy growth type companies.

Therefore, we would also, using our proposal, like to shift the savings on the integration proposal so that the capital gains tax could be less, because we feel that we want to support the creator, the fellow who in his own lifetime goes out and uses his money to do something constructively. Frankly, we are not too worried about the conserver. We all know that in England it is possible for these very large estates, with a little judicious planning, to pass from generation to generation. The money is not used too constructively and just flows down through the years. This is why we are willing to say that we would like to see a roll-over account, and we would be happy to see deemed realization at death in order to get this, but we want to favour the creator as against the conserver. We also want to favour the saver as against the consumer.

The Chairman: Mr. Bunting, I was wondering if you would clarify this for me. You said that the dividend tax credit plan that you propose would, I think your language was, cost $200 million less than the integration proposals.

Mr. Bunting: Yes.

The Chairman: In the White Paper they make a calculation that the integration proposals, if carried through, would produce a minus in tax revenue of about $140 million. How do I relate that? Do you mean that your dividend tax proposals will produce more revenue?

Mr. Bunting: That is correct.

The Chairman: There will be a plus?

Mr. Bunting: In essence, the income to the Government will be greater under our proposal than what is recommended in the White Paper. This is $200 million that theoretically goes to Canadian shareholders. What we are saying is that we, representing these people—our personal view, the Exchange's view is that as a group we are willing to forego that $200 million in order to have a system that will encourage Canadians to go into growth type situations. Frankly, we believe that in the long run everybody will be better off: the country will be better off; the people who invest will be better off; and we will have bought the future and we will not have bought back the past.

The Chairman: Yes, but is that $200 million that you are talking about tax revenue?

Mr. Bunting: It would be tax revenue for the Government under the White Paper proposal.

The Chairman: But under your proposal for a dividend tax credit as against the integration, what is the $200 million? Is it tax revenue or income, or what?

Mr. Kimber: Under the White Paper proposal the Government will lose $140 million. Under our recommendation they would not lose the $140 million and would pick up something over an additional $60 million, so there is a benefit to the Government. I suppose one must think that this has a disadvantage to some taxpayers, but the Government will have a net position $200 million better under our recommendation than they would under the White Paper integration proposal.

The Chairman: The reason the White Paper gives for abandoning the dividend tax credit is that shareholders of companies which do not pay any corporate tax get the benefit of this. What comment do you have to make on that?

Mr. Kimber: There is considerable logic in the thinking that went behind the White Paper proposal, but the result is not logical, in my view.

The Chairman: Why?

Mr. Kimber: I suppose we save three types of companies in Canada: ones that pay no dividend; ones that pay dividends but do not pay any taxes or do not pay sufficient taxes; and ones that pay dividends and sufficient tax. The White Paper proposal only gives the benefit to that third class of company. In fact, that is our more mature, stable company. So, all the bias is directly along that one line, and that is quite a substantial bias.

We say: Let us move back to our present system which directs the money towards two out of those three types of company. The additional bias the White Paper has given is again in favour of that third class of company, because of the imposition of a capital gains tax. So we say: Reduce the capital gains tax; that reduces the bias. And reduce the bias by going back to the dividend tax credit.

This does not answer your question, in that why should you give a tax credit to a company which is not paying taxes? But what are we attempting to do?

Senator Phillips (Rigaud): At least it mitigates the criticism directed by the Government because, in the final analysis, they improve their position by $200 million as against the proposed plan.

Mr. Kimber: That is right.

Senator Phillips (Rigaud): At least, it does that.

The Chairman: We have had some expressions of opinion as to whether you should limit the dividend tax credit to dividends paid by companies that pay corporate tax.

Mr. Bunting: From a shareholder point of view you really do not care whether the company is paying tax or not. The question is: Why is the company not paying tax? Very often, as was stated over here, the company is not paying tax because of some specific incentive that has been given to the company.

The Chairman: Yes.

Mr. Bunting: The effect is that it is illogical when it works out because the effect is that you give an incentive to the company which you take away at the shareholder level. As a consequence, the shares drop in price. If the company wants to go out and raise money in order to carry on up in that area where it has been given an incentive to go, it raises that money at a lower price than would otherwise be the case. We recognize that this is in essence an incentive, a form of incentive, and we are in favour of that particular incentive.

The Chairman: I refer you to page 47 of your brief where you talk about regional development. I think this goes back to some questions that Senator Hays was asking you. You will notice that at the bottom of page 47 under the heading "Regional Development", you say:

> We are concerned by the cavalier way in which the White Paper suggests that any adverse effects upon investment may be offset by resort to appropriate monetary and fiscal policies.

We were discussing this when we were talking about subsidy versus depletion allowances and tax holidays, where the person who gets the incentive has to earn it. What is your answer to the suggestion of the Government that there are other ways or appropriate monetary and fiscal policies which might achieve the same result. What could they possibly be other than subsidies or increased capital cost allowances?

Mr. Bunting: We would not have included, at least by our definition or what we understood when we wrote it, subsidies as part of monetary and fiscal policies. This is not our understanding of what they mean. It strikes us that monetary and fiscal policies are a macro-economic subject that sweeps with a broad brush across the entire country. Obviously, specific payments to companies and tax incentives work at the specific level at which you are trying to work, and that is why we are saying that these macro-economic things are not terribly effective on a regional basis, and this is very obvious at the present time where we have a policy that is obviously hurting some parts of the country much more than others.

Senator Connolly (Ottawa West): The Chairman was very specific in his question because he said: "What monetary and fiscal policies could be adopted?" Frankly, I am at a loss to know. When the Bank of Canada starts to implement monetary and fiscal policies—and presumably they are the people who originate them, together with the officials of the Department of Finance—what monetary and fiscal policies can they impose?

Senator Phillips (Rigaud): May I suggest deficit federal financing and the use of the funds by government for expansion.

Mr. Bunting: Yes, I suppose so.

Senator Phillips (Rigaud): That would be one funny phoney way of doing it.

The Chairman: Senator, you used both words "funny" and "phoney", did you?

Senator Connolly (Ottawa West): Yes, it is the funny and phoney things that we want to get out of the economy. I do not think there is anything that upsets the business community, or indeed the people at large, more than that kind of tinkering with the monetary and fiscal and economic system. But, is there a valid alternative to monetary and fiscal policy that you can suggest?

Mr. Kimber: The people in the Tax Department, and the advisers to that department, are more ingenious than we are. We say that this may well be true, but we suggest it would be difficult to do. Frankly, we have not been able to suggest how to do it with monetary and fiscal policy. Perhaps they have some solution.

The Chairman: You know, Mr. Kimber, they have a regional development program which involves pumping money into depressed areas, and the giving of grants for the establishment of new business in those areas. They used also to give the alternative choice of a tax holiday for three years. I realize that there is no logic in taxation—there is no logic, perhaps, in politics; it may be expediency that matters—but how you justify giving a tax holiday for the establishment of a new business in a depressed area, and then saying that a mining company that opens up an area like Labrador is not entitled to a tax holiday, I find difficult to understand. Did you conclude that they were referring to policies that they have for opening up depressed areas?

Mr. Kimber: No, we took this as having a wider meaning in the way of some general monetary and fiscal policies, and not the regional development programs.

Senator Cook: In view of the discussion, would you withdraw the words "This may well be true...", and leave the rest in.

The Chairman: Yes, I am wondering whether those words are surplus.

Mr. Bunting: I think so.

The Chairman: Do you withdraw them?

Mr. Kimber: Yes, sir, we will do that.

Senator Phillips (Rigaud): I would like to put two questions, because we obviously have very knowledgeable people here.

It has been suggested that the withholding tax in respect of payments made to non-resident creditors on funded debt, or debt generally, be eliminated on the theory that that would invite foreign capital to come in on the basis not of equity absorption but on the basis of creditor status. May we have your reaction to that?

I will put my second question now so that I shall not have to ask the chairman again to give me the floor. On the capital gains tax you have suggested, contrary to the general opinion expressed, that one-third of the capital gains be incorporated in taxable income. Unless I missed something, I am assuming that that goes into the graduated rates, even though the net result would be a resultant tax on capital gains in excess of 25 per cent. I think we should like some clarification on that point.

Mr. Kimber: On your first point, sir, we recommend that the same treatment be given to corporate bonds, corporate debts and securities, as are given to Government bonds—that the withholding be removed.

Senator Phillips (Rigaud): On the interest?

Mr. Kimber: Yes, on the interest.

The Chairman: That is the present law.

Senator Beaubien: No.

Mr. Thorburn: Not on corporation bonds.

The Chairman: But on Government bonds.

Mr. Kimber: On Government bonds there is no withholding tax. We say the same treatment should be given to corporate bonds. One of the reasons why we recommend that is that for the overall national good it is better to finance our development by debt rather than by equity. One of the reasons for this is that there are so many tax-free investment pools of capital, in the United States particularly, which are not the least bit concerned about getting tax credit because they do not pay any tax. So, those pension funds, university funds, and those thousands and thousands of...

The Chairman: Labour funds.

Mr. Kimber: Yes, labour funds. They do not get the benefit of the withholding tax down there. Therefore, the Canadian corporate bonds are not attractive to them. So, we recommend that the same treatment be given to corporate bonds as is given to Government bonds.

Senator Phillips (Rigaud): Is that in your brief?

Mr. Kimber: Yes, it is in our brief, sir.

Senator Phillips (Rigaud): Then I am sorry for asking the question.

Senator Beaubien: Mr. Chairman, I have a question on the same point. Have you made an estimation of what it would cost the Government if that withholding tax on corporation bonds were eliminated?

Mr. Kimber: I have heard a figure but have not verified it. It is in the order of $150 million.

I suggest that whatever the expense it would be well merited.

Senator Phillips (Rigaud): Is that specified in a recommendation in your brief?

Mr. Kimber: It is at page 24.

Senator Connolly (Ottawa West): In effect, Mr. Kimber, you are saying that this appears to be in line with a number of public discussions that have taken place. You want to make it more attractive for the foreign investor to invest in debt investment in Canada rather than in security investment.

Mr. Kimber: That is right. With regard to the capital gains approach, we suggest that one-third of the gain be taken into income and the graduated scale applied.

If there were a maximum of 50 per cent, under our rule the capital gains tax would be just under 17 per cent. However, we make a point with respect to the five year transition period where the capital gains tax under the White Paper proposal would be as high as 82 per cent. A capital gain might be realized in year one and 82 per cent paid because that will still be the maximum income rate at that time. Therefore we suggest it is completely inequitable. The Government refers to a maximum rate at 50 per cent, yet the taxpayer in the first five years may well be paying much more than that.

The Chairman: Mr. Kimber, my calculations indicate that if rather than attempting to reduce the 82 per cent in high brackets to 50 per cent, which the White Paper estimates would cause a loss of revenue of approximately $40 million, the rate were reduced to $40,000 at 55 per cent instead of 50 per cent sufficient revenue would be recovered to offset the reduction. An increase of 5 per cent in the rate on $40 million would recover $35 million.

Senator Connolly (Ottawa West): And there would still be a tax reduction.

The Chairman: Yes.

Mr. Kimber: Did you take into account the fact that there would be more capital gains taxes received during the first five years? Obviously if the tax rate is 82 per cent, people will postpone.

The Chairman: This could be done immediately because it would be known that the tax revenue would be provided to make up for the drop in the rate.

Mr. Bunting: Carrying the locking-in effect of the five years even further, the question arises why would a capital gains rate of 17 per cent be recommended? It appears that on the one hand you are in favour of capital gains and on the other setting a rate which is unreasonably low.

The New York Stock Exchange carried out a study on capital gains which indicates that if the rates had been lower in fact the turnover would have been greater and the income to the Government higher.

Their figures were suspect, so the U.S. Treasury Department reworked the study, arriving at even higher figures. They said the New York Stock Exchange had been too conservative in their estimates. Therefore a low capital gains rate tends to mitigate against the locking-in effect as well as conceivably giving greater income to the Government.

The Chairman: Do you have a copy of that study?

Mr. Bunting: We can make it available.

The Chairman: Would you have the reworking by the Treasury Department?

Mr. Bunting: I would have to check as to the reworking.

The Chairman: Could we have it reasonably soon?

Mr. Bunting: Yes, sir.

Senator Connolly (Ottawa West): The people in the United States could take their gains with the tax rate lower more regularly, re-invest and hopefully receive a further capital gain, even though they had to pay a smaller tax.

The Chairman: There might not be sufficient run at the end of the year to create tax losses.

Senator Connolly (Ottawa West): Exactly.

The Chairman: In discussing the small business, Mr. Bunting, you gave an indication of your concept of $3 million gross revenue.

Mr. Kimber: I was confusing the $3 million with the figure you gentlemen discussed in connection with the Canada Corporations Act.

The Chairman: We have not considered the amendments to the Corporations Act.

We have had quite a number of associations appear here, such as the Retail Hardware Association, the B.C. Forest Products Association, and quite a number of others, all of whom represent large groups of small business.

We asked them for a fair definition of a small business for purposes of the 21 per cent rate. It was suggested almost unanimously that it should be defined on a net profit basis, the suggested limit ranging from $50,000 to $100,000.

What comment would you make if we decided that a small business should be defined as one earning not more than $100,000 in order to qualify for 21 per cent on the first $35,000?

Mr. Kimber: Considering it from the capital market position we would require a company to have a net profit of $100,000.

Perhaps Mr. Lawson, who is the chairman of our listing committee, would speak to this.

Mr. D. G. Lawson, Vice Chairman, Board of Governors, the Toronto Stock Exchange: We require $1 million of net tangible assets when a company comes in under a record of earnings. We do accept some companies which do not have a record of earnings. However, the record of earnings requirement is $100,000 in their latest year and an average of $100,000 net profit in three out of the last five years.

Mr. Kimber: That indicates that a company at the $100,000 level of net profit would have a reasonable opportunity of financing in the capital market.

Senator Phillips (Rigaud): It approximates the definition of a small business for equity purposes of at least $75,000 or $100,000.

The Chairman: If you can list, you have some possibility of financing. Therefore on a net profit definition it should be a figure below $100,000.

Mr. Kimber: There seems to be considerable logic in that approach.

Senator Cook: Is that profit before or after taxes?

The Chairman: Before taxes.

Mr. Lawson: No, that is after taxes, net profit. We watch it carefully in terms of the accounting methods. Real estate companies were one type with a common approach. We tried to find special areas. It is after taxes and before special items, really. We do not take in non-recurring things, in spite of what they may say; we have had to be careful on that.

Mr. Kimber: Mr. Chairman, perhaps it would be helpful to you if we supplied a copy of our listing requirements.

The Chairman: Yes, it would.

Senator Carter: The Department of Labour in their White Paper seems to have developed another yardstick for small business based on weekly payrolls. I wonder if we could get the reaction to that type of criterion?

Mr. Kimber: This is completely novel to me. I have not heard of this approach.

Senator Connolly (Ottawa West): Is that not probably an approach made by the Department of Labour for a different purpose? I think it is. It has to do more with unemployment and insurance than taxation.

Senator Carter: Yes, but it is to distinguish between a large company and a small company.

The Chairman: Of course, the Small Business Loans Act, which was designed to help small business, started out with a sales limitation; that is, up to $250,000 of sales, which subsequently was raised to $500,000. We had the Bankers' Association here the other day, who told us that very little use was made of the Small Business Loans Act; that if a small company qualified on some basis of assets, etc., they would get a loan, quite apart from and independently of the Small Business Loans Act.

Senator Connolly (Ottawa West): In your experience in the Exchange, have you found the special concessions for small business in the tax field have resulted in small businesses becoming bigger businesses, and therefore bigger taxpayers?

Mr. Thorburn: Pulp and paper companies, and sawmills which move on to improving quality and a better range of product to provide raw material for pulp companies. This development is quite apparent in New Brunswick.

Senator Connolly (Ottawa West): Could you document this for us, taking as a start the time when this item was injected into the Income Tax Act? Do you think you could produce a set of statistics to indicate how small businesses have in fact under this special incentive become bigger businesses, and therefore bigger taxpayers?

Mr. Thorburn: Might this be done with several examples?

Senator Connolly (Ottawa West): I would say almost any way that would be convenient to you, which will help us.

Mr. Thorburn: We will certainly try it.

The Chairman: That would mean starting in 1949, when this was first introduced.

Mr. Thorburn: I think it could be done. We could make a good stab at it.

Senator Connolly (Ottawa West): I think some concrete examples might help.

The Chairman: Yes. We do not need a lot of them.

Senator Connolly (Ottawa West): Oh, no.

The Chairman: Just a few to illustrate it.

Senator Connolly (Ottawa West): You could probably give us some indication of the trend, and perhaps the areas where this has happened.

The Chairman: Senator Phillips, I was wondering whether you had noted on page 17 one of your favourite points—the deficiencies of the integration proposals—and whether you had any comment?

Senator Phillips (Rigaud): I think the presentation is pretty clear.

The Chairman: The calculation there is rather interesting, as to the advantages to the closely held corporation on integration in relation to dividends as against widely held companies. Of course, the moment you take small business out of closely held companies and deal with it separately, the whole thing collapses.

Senator Phillips (Rigaud): Exactly, particularly in the light of the proposed treatment of dividend tax credits, showing a benefit to the government to the tune of $200 million. It is pretty clear that would give a sort of death blow to the integration system.

The Chairman: Mr. Kimber, you have no comment on the partnership option as proposed in the White Paper? Let us assume there is a separate category in taxation for small business, which would be a 21 per cent rate. Ordinarily, because the small business is unincorporated, the marginal rate of the one that would enjoy that may conceivably be less than 21 per cent. If it were more than 20 per cent, do you see any value in providing constructively an option for an unincorporated small business to pay constructively the 21 per cent on its net profits rather than the members of the small business paying at a marginal rate?

Mr. Kimber: I think there should be such an option. We did not cover this in our brief, because it occurred to me when working through this that I suppose most of those companies could incorporate. When I was practising law it used to be pretty cheap, but rates have probably gone up since then.

The Chairman: I can tell you that they have, yes!

Mr. Kimber: There are some groups who, perhaps for professional reasons or something else, cannot incorporate. I would see no reason why a group of taxpayers or a partnership should not be able to elect to have the same treatment as the corporate body; again referring to the small business type of situation.

Senator Burchill: Earlier in our discussion Senator Beaubien stressed the difficulty an ordinary taxpayer might have if the system is made too complicated, and I am very concerned about this. We have had several witnesses, associations and other people, before us who have agreed that if the proposals of the White Paper are adopted the administration will be very complicated to start with at the Government level, corporations will have many more difficulties than they now have, and many ordinary taxpayers will have to employ a chartered accountant or a lawyer to make out the forms. Have you given any thought to that feature of it?

Mr. Kimber: The question first came up, I believe, in connection with the rollover

account. This, of course, is an option the man can elect. If he does not want to get into any bookkeeping he can just not elect. In fact, we feel the bookkeeping would not be all that complicated. Perhaps I should send to you a form showing how it could be done. Perhaps I might supply that to the committee Mr. Chairman.

The Chairman: Yes.

Mr. Kimber: There are administrative problems that arise out of this set of proposals. We see particular administrative problems in the integration area, such as a company trying to keep track of its tax position and the crediting to the various classes of shareholders, and so on. We think this would be a large administrative problem.

The payment of the profits by way of a stock dividend, in our opinion, would recreate great administrative problems and expenses for corporations. It might be practical for small private companies to do it, but not for the major ones. First of all, they get away from board lots which is expensive for the recipient and start getting into split shares which would create all kinds of administrative problems. There is also the cost of mailing out share certificates as opposed to mailing out cheques. These things are all administrative problems which we think only add to the burden of the taxpayer and the Government. That is one reason why we oppose integration, but our more fundamental reason is that it is a bias against growth.

Senator Benidickson: Mr. Chairman, there are one or two items in the brief which have received some comment: the approval of the capital gains tax which would go up to 33 1/3 per cent, and the dividend tax credit, which is referred to as integration, would be graduated on a basis that would favour the lower income taxpayer, et cetera. That, of course, establishes the objectivity of the brief, which I congratulate you on.

Some of the most interesting and perhaps novel parts of the brief, as far as presentation to this committee is concerned, are the appendices. By reason of information that has been provided to you I suppose everything in Appendix A is a matter of public information?

Mr. Kimber: That is right.

Senator Benidickson: But you are the custodians of it. With respect to Appendix A, in what particular ways have you placed this in order to reinforce other parts of your brief?

Mr. Kimber: Senator, one of the arguments presented in the White Paper to support the distinction between the widely-held and closely-held companies is that the securities of widely held companies are readily transferable. If you look at Appendix A you will see the company Abel-Black Corporation Ltd. All these companies which we show in Appendix A were listed in 1961 on our exchange. You will see that 80 per cent of the stock of that company is held by the directors and officers of the company, and that 80 per cent is not readily marketable. It does not meet the test of the White Paper.

In addition to the White Paper it says that in closely-held corporations management has some kind of personal relationship to the company. It does not have it in the widely-held corporations. Mr. Abel and Mr. Black, who own 80 per cent of this company, I submit have as strong a personal relationship to the company as they did before. They assumed some additional responsibilities, because now they have public shareholdings but their relationship with the company is still as strong.

Senator Benidickson: Your use of this appendix is to reinforce your argument that there is discrimination. If we have two forms of companies for tax purposes discrimination results.

I notice in Appendix B that you refer to the York study. This has reference to 140 large Canadian private companies with assets in excess of $25 million. I think this is interesting to senators, because we are currently considering an amendment to the Canada Corporations Act where it has been alleged that it is difficult to get pertinent information with respect to private companies. I can understand why almost 80 per cent of these large private companies are controlled by non-residents, because I notice that many of them are well-known subsidiaries of well-known American companies. With respect to some of the others, particularly those which are not non-residents, can you tell us what the public availability of information would be for the York study?

Mr. Kimber: We will supply you with a copy of the York study.

Senator Benidickson: Do you know offhand or does it indicate there just where they get information as to a private company and whether its assets are over $25 million, and so on?

Mr. Kimber: This study was headed up by a professor at York University who had done some work for the Government in connection with the Carter Report and, as has been mentioned, the information came from the Canada Corporations Act.

Senator Benidickson: Which is a relatively new statute.

The Chairman: It goes back five or six years and all companies had to file their financial statements. Is that not correct?

Mr. Kimber: Yes.

The Chairman: And that information is public?

Mr. Kimber: Yes. This was a study commissioned by the exchange, but done independently by York University.

Senator Benidickson: With respect to Appendix C, what is it endeavouring to establish in relation to your brief, liquidity or the lack of liuidity?

Mr. Kimber: Yes. Our major financial institutions tend to invest in the same companies which make our market liquid. One of the problems Canada has faced in the last several years is the large amount of Canadian savings which has been invested in the United States market. When the institutions are asked why they do this they give two main reasons. One is that there are certain opportunities in the United States for investment which are not available in Canada. They also make a very strong argument that they invest in the New York market because of the liquidity of that market. Canadian savings are being funneled out of the development of Canadian industry into the United States because of the large liquidity of the Canadian market. The White Paper, in our view, increases the problem by removing liquidity.

Senator Benidickson: I wanted to get some of these things on the record. Appendix D again just simply establishes, I take it, the fact that it is not very realistic to accept rather closely-held corporations and widely-held corporations because the companies listed, while they may have certain types of stock listed, do not have voting shares.

Mr. Kimber: That is right, sir.

Senator Benidickson: They are voting shares.

Then, Appendix E, that is really on the same subject, except that we have been using the classic example of the fact that Eaton's and Simpson's are different. You give us a very wide list of companies that are in the same line of business but one is closely-held and the other is privately-held and they are in competition.

I note with respect to Appendix A you are giving us here, I take it, the benefit of your expertise, in showing what it means in taxes to companies who want to change their status or who would feel that it would take into consideration the possibility of change from closly-held to widely-held corporations and the tax impost that results, and it might discourage that transferability.

Mr. Kimber: Did you say Appendix A or Appendix H?

Senator Benidickson: Appendix H.

Mr. Kimber: Yes, sir.

Senator Benidickson: Then I think you have given us some more information than perhaps other presentations, in Appendix I. This supports what you say on pages 40 and 41 of your brief with respect to double impost of a capital gain and an estate tax.

Mr. Kimber: Yes, sir.

Senator Benidickson: I was not familiar with the reference you make on page 41, where you say:

> We recommend that consideration be given to the proposal in the White Paper attached to the Ontario budget...

"The White Paper of the Ontario budget of 1969"—you continue:

> ...there it was proposed that, in proportion to the degree of reliance upon capital gains taxes, there should be decreased reliance upon death duties.

I take it that they were just anticipating that at some time there might be a capital gains tax.

Mr. Kimber: That is right, sir.

Senator Benidickson: They have not a capital gains tax in Ontario.

Mr. Kimber: No.

Senator Benidickson: And they were not suggesting that there would be one, in that jurisdiction.

Mr. Kimber: I think, senator, in the colloquial sense the Government said that a capital gains tax is a form of "pay as you go estate tax".

Senator Beaubien: Before you go.

The Chairman: It is pay before you go. You mean "pay as you go along". We were told this the other day by a member of a board of trade group. He had been in the provincial comptroller's office—I think he was the comptroller for a while—and he referred to Mr. Frost's definition of a capital gains tax vis-à-vis succession duties, and he said that the capital gains tax was an "instalment payment of succession duties".

Mr. Kimber: Yes. Certainly the two taxes have to be considered together.

The Chairman: Certainly there should be a credit of one against the other, in any event. Would you agree to that?

Mr. Kimber: That would seem to be a very logical way of approaching it.

Senator Phillips (Rigaud): That brings me, if I may, to this point. We have taken a lot of time on this last question and we are indebted to Senator Benidickson, who has analyzed these various schedules. If you provide a withholding tax up to 25 per cent on dividend tax credits, and if there is legitimacy to the problem of relating capital gains to estate duties, why do you bring the capital gain into taxable income, and why do you not support the recommendation that most other taxpayers have made, that we have a flat capital gains tax, segregating the income thereon?

In this way, if you had a flat capital gains tax in respect of profits and we followed your system of withholding taxes, from 15 to 25 per cent—I am not dealing with the rates but with the principle—you could segregate it and relate it to the estate tax problem of the provinces.

Whereas, in the way you have done it, you take one-third of the capital gains tax and you bring it into the graduated income of the taxpayer and it gets lost, in identification, from the point of view of relating it to the estate taxes.

Mr. Kimber: Perhaps the thought that is being put forward in your question is that the capital gains tax might be on a sliding scale. .

Senator Phillips (Rigaud): Yes, that is right, unsegregated.

Mr. Kimber: ...that it would have a considerable degree of equity in it. I think one might be able to argue that a flat capital gains tax may have the same inequity that the flat dividend tax credit has. But what you have suggested would eliminate that argument.

I am not so certain, though, sir, that the capital gains payment would be lost under our provision. You would still take your capital gain into your income and if you had the 50 per cent rate, you would pay 17 per cent, or if you were at the 25 per cent rate you would pay 8 per cent. I think you could still do it.

Senator Phillips (Rigaud): You could identify it. Yes, I think you are right.

The Chairman: Now, Mr. Kimber, at this time when we feel we have gone through your submissions very carefully. But I always reserve this question. If there are any features that we have not touched, if there are any points that you would like to stress further, now is the acceptable time.

Mr. Kimber: There is one point we make in our brief but in this case we do not differ from the White Paper proposal. We are not in favour of the argument which some people put forward that capital gains made in a certain period of time would be treated as capital gains and those made over a longer period of time should not be treated as capital gains. We do not see any economic justification for that or any great logic in it. If there is to be a capital gains tax, it is a capital gain, no matter what period of holding there has been.

The Chairman: Except this, Mr. Kimber, that we have a lot of jurisprudence as to what is a capital gain and what is not. You have a situation which I call "making a fast buck", where you buy and sell within a short period of time, which takes on the characteristic of a business. If it takes on the characteristics of a business, should not the proceeds be treated, and any gains should really be income.

Mr. Bunting: We would not disagree, that if you are making a business of trading for short-term profit, that you should pay on a capital gain.

Mr. Kimber: That would not be a capital gain—if I may interrupt—that would be income.

Mr. Bunting: Income. Yes, I am sorry. The point we are really trying to make on the

split rate is that our markets in Canada are highly illiquid, and we do not feel, we do not believe that we can afford to lock people in for that six month period. When an institution wants to sell a block of stock, he does not care really who is on the other side or whether they are making a short-term profit or not. All he cares is that he is able to sell his stock.

If a person on the other side, let us say any individual, takes possession in a security that has been sold and he provides a time function—in other words, one person wants to sell immediately, another person in essence knows that over the next three weeks X number of shares will trade—if he takes on a block of stock, let us say, that he can lay it off—he is providing a legitimate time function in the market; and in our Canadian markets we cannot afford not to have that liquidity in there. This is really the key to our argument on the split rate. It is the liquidity question which is absolutely crucial.

In the last three or four years we have worked continuously to try to bring the maximum number of opinions to the market so that we could have a market which provided opportunities to the security based on the outside facts, and not related to the fact that there was no bid because of liquidity reasons. But that really reflected the way it was.

If we create a situation where a person has to pay the full income rate during the six months, then there will be many securities that will be much harder to sell, and we might create a non-liquidity situation in our market.

The Chairman: Well, the problem, Mr. Bunting, is to have a simple way of identifying a capital gain and time is a very simple way. The difference in time between the acquisition and sale does not present too many problems, but if you are going to get it back, then, first of all, you have to determine what is a capital gain and what is income, such as we have now under the law. You will still be left with that by the method you have suggested.

Mr. Kimber: That is true, sir, but our jurisprudence has become rather sophisticated. We have had a lot of problems, but now I think we have a solid body of jurisprudence.

The Chairman: Well, your method would maintain that.

Mr. Kimber: Yes. May I make one other remark, Mr. Chairman? I personally have found this a very fruitful exercise and I do want to thank you for having us here. We trust we have added something to your deliberations.

The Chairman: I can assure you that you have. Thank you.

The Chairman: Now, honourable senators, the next submission is from the Independent Petroleum Association of Canada.

Honourable senators, we have Mr. A. H. Ross, Director and First Vice-President of the Independent Petroleum Association of Canada. He is going to make the opening statement and he will present his panel.

Mr. A. H. Ross, Director and First Vice-President, Independent Petroleum Association of Canada: Gentlemen, before making the opening statement I should like to introduce the panel to you. On my immediate right is Mr. Harry Van Renssalear of Bow Valley Industries. Next to him is Mr. Vernon Van Sant of Ashland Oil, and at the end is Mr. Barry Rombough of Home Oil Company.

I believe that we indicated to you before that we would have Mr. Ruben here.

The Chairman: Yes.

Mr. Ross: However, Mr. Ruben is not able to attend. Mr. Van Sant has come in his place.

I shall now proceed to the opening statement, and at the end of the statement we shall be pleased to answer any questions.

The Independent Petroleum Association of Canada greatly appreciates this opportunity to present its views on matters pertaining to the tax reform proposals. IPAC is composed of 176 companies of which 131 are Canadian companies actively engaged in exploration and production. The majority of our members derive substantially all of their cash flow from domestic reserves, thus, detrimental changes in Government policy directly affecting these industries will result in a reduction of our members' ability to finance and/or their cash flow.

It is important to realize that independent companies are extremely active in exploration, being responsible for over 50 per cent of all exploratory wells drilled in Canada. This association is extremely concerned with the economic impact these proposals will have on the Canadian economy if implemented. It is our view that economic growth will be slowed.

By and large, we have only dealt with those matters affecting the oil and gas industry since we can relate to them directly. However, we would not wish to imply that this is our sole concern. We have grave reservations about, first, the proposed system of taxing capital gains; second, the artificial distinction between public and private companies; third, integration of personal and corporate income tax; fourth, the removal of special tax treatment of small business; and, fifth, the tax treatment of natural resource industries.

In so far as the petroleum industry is concerned, I would like to highlight some important considerations, namely, the risk, the size of investment at risk, and the capital intensive nature of the industry.

As you gentlemen are aware, the risks involved in exploration for oil and gas are much greater than those in any other industry in Canada. The odds of finding sizeable reserves are long. Some 13,500 new field wildcats have been drilled in Canada since 1950, and only one field had oil reserves over one billion barrels and only 25 had oil reserves over one million barrels. In other words, it took over 500 well caps to find a major oil pool.

It is also interesting to note that oil men have to be perennial optimists since only three fields of over 100 million barrels have been found in the 1960s, with the last one found in 1965.

The size of the investment at risk in a single exploratory well can be very large. Foothills Wells cost some half a million to two million dollars. A well in the Mackenzie Delta can cost up to $2 million and a wildcat on the north slope of Alaska can cost between $5 million and $9 million.

As exploration moves further into sparsely-populated areas, the cost rises materially due to the lack of roads, towns, communications and transportation facilities.

In our brief we have indicated projected capital requirements of $20 billion to $30 billion in the next decade. These capital requirements come at a time when world industry faces great capital demands. In the 1950s the world industry spent $70 billion, in the 1960s some $150 billion and the estimates for the 1970s are $255 billion. Obviously Canada's investment climate will have a material bearing on our ability to attract the capital requirement.

In the past the gross depletion allowance has proved to be an effective incentive in attracting investment to the worldwide oil and gas industry. Adequate incentives become even more important for the future in the face of increasing capital demands from all sources. Reducing the incentives, as proposed by the White Paper's so-called "earned depletion" will present problems to the industry in Canada in pursuing its programs.

We believe that Canada would be well served by adopting our proposals which would really attract capital and stimulate exploration by ensuring a reasonable return to successful explorers.

The oil and gas industry has made a significant contribution already to regional development and to the Canadian economy generally. It is our view that it can make even a greater contribution in the future, given adequate incentives. Thank you.

Senator Isnor: Where would you expect to get the capital?

Mr. Ross: New capital, sir, we would hope to get, at least some, in Canada. This is why we have recommended in our brief that the principle of business test be done away with. It is obvious that, with the amount of capital we require, we will have to go into the world money markets, that is, into the United States and probably into Europe.

Senator Isnor: What percentage do you expect to get in Canada?

Mr. Ross: We think that is extremely difficult to tie down to a percentage.

Mr. H. Van Renssalear, Director, Independent Petroleum Association of Canada: We think we are going to have to raise over and above our cash flow probably $7 billion or $8 billion within the next ten years. I think it would be unrealistic to expect that we could get perhaps more than 25 per cent of that from Canadian sources.

A number of independent companies have acquired large capital inflows from both Canada and the United States. Their ratios have run currently for the last ten years, perhaps, 18 to 20 per cent from Canadian sources and the balance principally from the world financial community.

The Chairman: Would the Canadian sources be equity capital?

Mr. Van Renssalear: This is an interesting point, Mr. Chairman, because in our industry, until we make the big discovery, debt financing by and large is not appropriate. Most of

our debt financing, when it does occur, is always accompanied by an equity sweeping, or most likely to be accompanied by an equity sweeping. So we are talking really about equity capital.

The Chairman: You mean it is equity capital that makes the discovery and debt financing that produces the facilities for getting the oil out of the ground and getting it to market?

Mr. Van Renssalear: Once we have the big reserves, then we can get into senior financing, but the exploration phase of it does not lend itself to debt financing.

The Chairman: Percentage-wise, where would most of your equity capital come from, domestic or foreign sources?

Mr. Van Renssalear: It is hard to generalize. In specific relationship to our company, Bow Valley Industries, the one with which I am associated, we are currently approximately 47 per cent Canadian owned and 53 per cent owned throughout the rest of the world. We have been able to keep this high Canadian ratio while we have raised approximately $40 million in drilling funds and equity capital with about 82 per cent of that coming from foreign sources. So in our situation, we have been able to maintain our Canadian ownership while getting the great majority of our capital from abroad.

One reason we are able to get capital from abroad more easily than we can get it from Canada is that tax laws in the United States permit any individual or any corporation to explore for oil and gas anywhere in the world and write those expenses off against their regular income, whereas Canadians are at a distinct disadvantage under the present tax laws as compared with U.S. citizens and corporations in exploring for oil and gas in Canada. The proposals in the White Paper which would permit Canadian individuals and corporations who are not so-called qualified corporations or individuals to write off 20 per cent of their exploration expenditures on a declining balance method is not sufficient considering the risks in the exploration phase of our business to attract much Canadian capital, in our opinion.

We would hope that the law would be written in a way that would permit Canadians an equal opportunity with foreigners to invest in Canadian oil and gas projects. But even if that was done, the fact of the matter is that with the level of expenditures that we require to maintain the momentum and employment we are providing for our part of the world and for all of Canada, we are going to have to rely very heavily in the next decade on foreign capital.

The Chairman: What do you generate in the way of retained earnings to put back into your exploration operations?

Mr. Van Renssalear: Most of our companies are independent companies who are plowing back their cash flow.

The Chairman: No dividends?

Mr. Van Renssalear: No. They are plowing them back into exploration activities, and this is the reason why most of us are not paying taxes currently because all of our money is going back into exploration in the hope of making that big discovery. For instance, in Bow Valley's case, we use the cash flow from our various operations and augment that with drilling funds or drilling participation from U.S. investors so that we have a program of about $5 million a year, and our investors have put with us now a little over $17 million and the fair market value of their oil and gas reserves over the last ten years have only been about $4½ million. So their pay-out is still to come in the future.

The Chairman: What security do they have in this drilling fund, or whatever you call it?

Mr. Van Renssalear: The method in which this type of participation is financed is roughly as follows; the U.S. individual taxpayer puts up the risk money and the Canadian company handling that money usually takes a management fee that runs up to, perhaps, 10 per cent, and then has the right, in the event of a discovery, to buy back in 25 per cent or perhaps more of the interest at the investors' cost. Then the U.S. investor really desires to turn around and sell that property, in most cases, back to the Canadian company, if he can do so. If he makes a big discovery, of course since 1962 under Canadian tax law, he is taxed at ordinary income tax rates so that he is vitally concerned with the depletion rate in order to provide incentive, if he makes that discovery, to recover his investment and make a reasonable rate of return, considering the risks that he is taking.

Mr. Ross: Our company, Western Decalta, Mr. Chairman, has in the last ten years spent $31 million on exploration and development, and our cash flow has been about $21 million,

and we are currently spending more than our cash flow, and I think this is true of many companies.

Senator Phillips (Rigaud): I notice that the identification of your group is the Independent Petroleum Association of Canada. Do I take it that as a committee we have to deal with your problems in a way differently from that applicable to the huge corporations identified as the major oil companies controlled out of the country?

Mr. Ross: We have a different association because in a number of instances our interests are different from the major companies as you refer to them. However, in regard to taxation, our approach, while slightly different from theirs, is not perhaps in the final result too different. We have made reference here in the first instance to the ability of Canadians to write off or disregard the principal business test under exploration and development expenditure. The major companies have not dealt with this subject, probably because they do not have the same requirements for capital or to attract capital to their situation as we do. There are some other minor differences also, but by and large I would think that our approach in this case is about the same.

Senator Phillips (Rigaud): The briefs that have been filed by some of the large companies are now public—Imperial Oil, Texaco, Gulf and Shell—and I assume they have been studied by you. There are variations in their respective approaches with respect to how to deal with the subject matter. Have you, having studied those briefs, and relating to your suggestions, come up with a basic consensus more or less as to what should be done by way of incentives, and do you draw a distinction between the incentives that should be given having regard to wells now in operation and resulting from the then legal incentives as distinguished from what the incentives might be for the future.

Mr. Ross: If we were to equate the proposals of the companies you mention and perhaps some other ones as regards depletion, it would appear that the industry would like to have a gross depletion. The industry also recommended this back in the days of the Carter Report. There are variations on that theme, and it is a function of how you work out the numbers to see the exact effects. However, it would appear that most of them are in the order of about a 20 per cent gross depletion. We have done some work on our own numbers, and as I say, I do not want you to think that what I say here is exact, because if you change the mix, you get different answers. But our proposal would appear to be about a 21 per cent gross depletion if you run it through on some basis, and I think this is about what the others are looking for also. If you go over to the earned depletion concept there are some other differences. Under the earned depletion concept we asked for exploration and development costs and land costs to be included. Under the earned depletion concept we ask for exploration development cost and land cost to be included, and we also request a 1-for-2, or a $1 of earned depletion for each $2 of expenditure.

Senator Phillips (Rigaud): Is not the 1-for-2 the Imperial Oil situation?

The Chairman: No, that is the Gulf. The Gulf proposed 20 per cent unearned and 1-for-2 of earned depletion.

Mr. Ross: I believe Imperial did also. The problem is that you get so complicated with regard to other variations that they get in there. In other words, they want a gross depletion, but if they cannot have this then perhaps they will take something else, and then they will take something else. So it depends which end of the gain you are looking at, but they would all prefer a gross depletion, and certainly CPA would, in the order of a 20 per cent gross.

The earned depletion on a 1-for-3 basis and on the restrictive basis of the White Paper whereby they disallow land cost is not acceptable, as far as I know, to anyone in the industry.

Senator Phillips (Rigaud): I take it, then, dealing with the subject matter in this connection, there is no particular problem in dealing with the independents as distinguished from the major companies?

Mr. Ross: Not in so far as depletion is concerned, except that our emphasis, of course, is very strongly on the capital requirements of the industry, and we depend on outside capital to a much greater degree than they do. We must have laws that are attractive. They can go elsewhere, to a great degree, if they do not like it here.

Senator Phillips (Rigaud): I thought we would take it, if I may suggest, on an orderly basis.

Mr. Ross: Sure.

Senator Phillips (Rigaud): In so far as depletion is concerned we will deal with the industry at large, and on that basis you come up with a specific recommendation in your brief.

Mr. Ross: Yes, sir.

Senator Phillips (Rigaud): If the Chairman will allow us, could we identify it specifically in your brief and see specifically what you are asking?

Mr. Ross: This is on page 13 of our brief. Our recommendation there is that we be granted a 15 per cent gross depletion, but each year you could have the alternative of taking a gross depletion or electing to take an earned depletion. The earned depletion would be on the basis of $1 of earned depletion for each $2 expended, limited to 50 per cent of the net. The White Paper is limited to 33-1/3 per cent of the net.

The Chairman: In the depletion you ask for of 15 per cent you say, "calculated on gross production income after royalties but before any other deductions..."

Mr. Ross: Yes.

The Chairman: What do you mean by "before any other deductions"?

Mr. Ross: Operating costs, drilling and exploration costs are "other deductions". Under the current proposals you get 33-1/3 per cent of the net. You have to deduct your royalties, your operating costs and any drilling and exploration expenditures. That gets you down to the net, and then you get one-third of that. So this limitation is much less and much more favourable, obviously, than the current one.

The Chairman: How many of your members have earned depletion in the last year?

Mr. Ross: Do you mean under the type of proposal...

The Chairman: I mean that have made enough money so that they can take the depletion incentive.

Mr. Ross: I do not think we have that figure. We could get it for you and supply it to you.

The Chairman: Hudson's Bay Oil and Gas were here and they said that 1969 was the first year in which they earned enough money to be able to take the depletion allowance.

Mr. Ross: Yes, or even part of it.

The Chairman: Shell Oil still have not got into a net profit position that makes them subject to tax. That could mean, of course, that they may be earning a lot of money, but their exploration expenses may be very high.

Mr. Ross: Yes. This is true of certainly a lot of members of our industry as well. Our own company, for example, does not take depletion under the current basis because our expenditures exceed our cash flow. So, therefore, we would not qualify for depletion on the basis that currently pertains.

The Chairman: But apparently you have been able to operate without taking the depletion.

Mr. Ross: We have, as an individual company, sir, but the trouble is that there are a lot of funds required from outside, and if you do not have the incentive of depletion, then the people calculate their after-tax income as though they were taking it, and if there is no depletion allowed then their after-tax return is lower than it would be otherwise.

The Chairman: I suppose unearned depletion is only valuable if you would otherwise be subject to tax.

Mr. Ross: That is correct. However, there is another effect, really. You take a company such as ours. When the security markets evaluate our company, they do a projected cash flow over a number of years, and they take out the expenditures and deduct the depletion as though we had discontinued exploration. Then they bring it all back on present worth and this gives them the value of our securities. Obviously, if there is no depletion under those circumstances, then our company is worth less money than it would be under the status as it applies today. Also, if we go to sell a piece of property, in order to take the money and perhaps put it into exploration or do something else with it, the person buying the property, if it is not subject to depletion, will pay less money for it than he would otherwise. So there is a real effect, even though he may not be using it directly in the actual calculation of net income.

Mr. V. Van Sant (Member, Independent Petroleum Association of Canada): As far as investors in our own securities are concerned,

both Canadian and foreign, and direct investors whose funds participate with us in exploration, the depletion calculation is extremely important to them even though they are not in a position to take it, because in determining whether they are going to make this investment in Canadian securities vis-à-vis the securities of oil companies operating outside of Canada, they have to consider what their position would be if the company was successful and made a big discovery, or if they were successful and participated directly in such a discovery. So it is of vital concern to the independents even though we are currently not taking it in most cases, and very few of our members, if any, probably are taking it.

Mr. Ross: If you take the situation of an American investor, he has this particular year some income he would like to invest in oil and gas, so he comes to Canada and drills some wells. Let us assume that he makes a reasonable discovery, but after a couple of years he does not wish to drill any more wells and just wishes to enjoy the income that he would get from his property. Under the proposals of the White Paper he would obviously be subject to higher tax rates than currently.

The Chairman: He would be subject to the full rate of tax.

Mr. Ross: That is right. So, consequently, he looks at the situation as it will pertain if he is successful, and he therefore finds the White Paper proposals to be less attractive than the current proposals and, to that degree, will reduce the amount of capital available to the industry.

The Chairman: That is a sound argument for dividing the depletion allowance as between earned and unearned.

Mr. Ross: This is why we have put in an optional basis, so that if the taxpayer thinks in terms that he may want to explore for a couple of years and then take his production and not explore, he can go on the gross basis. Conversely, if he is expending a lot of money through exploration, he can elect to go on the earned basis.

Senator Phillips: Mr. Chairman, from your depository of memory would you know whether this suggestion approximates any of the suggestions made by the companies to which we have just referred?

The Chairman: We have not had the options discussed. If you were going to have options I would have thought the option might be between taking unearned depletion and taking earned depletion.

Mr. Van Renssalear: That is what ours did.

The Chairman: I thought yours assumed a $33\frac{1}{3}$ per cent overall, which is the present depletion allowance, and your suggestion, I gather, was the same as that made by some others, namely, that 20 per cent be on earned—in other words, that you could take it whether you do any exploration or not.

Mr. Ross: Our suggestion is 15 per cent.

The Chairman: Whether you do any work or not?

Mr. Ross: Yes, exactly.

The Chairman: But you do go for a divided...

Mr. Ross: Well, except in the way we have proposed it the taxpayer in each year must elect which method he is going to go by. He must take either, as you call it, the unearned which is 15 per cent of gross, or the earned depletion if that fits the situation better.

The Chairman: You do not suggest that he be able to take both in the same year?

Mr. Ross: No.

The Chairman: Then that is a big difference between what you suggest and what a number of other companies have suggested, because they wanted a bit of both worlds.

Senator Phillips (Rigaud): Yes, on page 13 you provide specifically for an optional system.

Mr. Ross: That is right, and we feel that this would be effective in attracting capital to the industry.

The Chairman: Outside of depletion, are there other items. For instance, have you anything to say about eligible expenditures?

Mr. Ross: Our eligible expenditures, sir, are certainly very different from eligible expenditures in the White Paper, because we include land costs. We have not included gas plant costs and pipe line costs, and that type of thing, but I believe some of the other people have. We would not want to include secondary recovery costs because we believe they fit into the same category as development costs.

I think in fairness I should indicate that our brief does not spell out land costs, and we recognize, as the testimony before you has already indicated, that there could be a problem on trading or swapping between companies to create eligible expenditures. Obviously, that has to be closed. We would want to think more about it in terms of finding a better way than just allowing Crown reserves, and in the absence of a better system then purchase from the Crown would be the logical way to do it.

The other difference that we have noted on earned depletion, and which perhaps I should mention, is that we limit it to 50 per cent, while most of the other limitations have been 33⅓ per cent.

The Chairman: Even the White Paper Proposals on earned depletion have an overall limit of 33⅓ per cent.

Mr. Ross: Yes.

The Chairman: That is on the net.

Mr. Ross: Yes.

The Chairman: But they also permit you to carry forward.

Mr. Ross: Yes, sir.

The Chairman: Have you any comment to make on that?

Mr. Ross: Well, it would be pretty drastic if you could not carry forward.

The Chairman: But you cannot carry forward at the present time.

Mr. Ross: That is true, you cannot carry forward at the present time. However, with carry-forwards or anything else, under the White Paper it is not as attractive as the current system. That proposal helps a bit, but it still does not get up to the level of the current system, because under the current system we get 33⅓ per cent automatically.

The Chairman: I seem to recall that one of the other companies—I think it was Gulf, and perhaps you recall it, Senator Phillips—said that 20 per cent on earned depletion plus an earned depletion on the basis of $1 for every $2 you spend would about approximate in result the 33⅓ per cent depletion to which you are entitled at the present time.

Mr. Ross: I gather the problem with it is that if you make that calculation you can get different answers. But when we ran it through, as I indicated, we felt that the current system was about the equivalent of a 15 per cent gross, so if you had a 20 per cent gross we would think that would be higher.

Mr. B. Rombough, Chairman, Tax Council, Independent Petroleum Association of Canada: The only comment I could make on that is that if you take the White Paper and also the effective tax rates into account, then the best tax rate you could have is 33⅓ per cent, and you could move as high as 50 per cent. I think the attempt in the high tax proposals is to put a ceiling of 42½ per cent on our tax rate, and to give us the chance of getting a 25 per cent tax rate if we carry out an aggressive exploration program. Our numbers are worked in that range. I have not examined the Gulf proposal.

The Chairman: You have not said anything about the position of the shareholder vis-à-vis depletion. The White Paper takes away any right to a depletion allowance on the dividends that the shareholder may get.

Mr. Rombough: We have dealt with this...

The Chairman: I mean that we have not dealt with it in our discussion here today.

Mr. Rombough: We are concerned about that. We believe that we are losing the depletion allowance for our shareholders, and of course, we are concerned about the loss of the dividend tax credit. Those two things, we feel, create a bias against the securities of our industry. As a matter of fact, we have recommended that they both be continued and, if anything, that the dividend tax credit be incresed to 25 per cent.

The Chairman: You heard some discussion here this morning with the Toronto Stock Exchange on the question of how the dividend tax credits should be treated. They suggested a sliding scale which, in effect, would produce plus tax revenue as against the integration proposals which produce a minus.

Mr. Van Sant: We certainly do not like the integration proposals because we think they will have the effect of channeling Canadian capital into the slower growing, higher tax paying Canadian companies, and away from the natural resource companies. We are totally in agreement with the testimony we heard here this morning in that respect.

The Chairman: With respect to interest in foreign capital, what would you think would be the effect of the White Paper Proposals?

Mr. Ross: I do not think there is any question, sir, but that they would decrease the amount of foreign capital coming into the industry.

The Chairman: Why?

Mr. Ross: Because under the proposals their effective tax rate is materially increased, and under the production that is here currently the value is decreased. I think that even despite the dollar cost you have a loss of confidence that enters into the situation as well.

Mr. Van Sant: I think there are a number of reasons why it would drastically reduce the amount of foreign capital coming into our industry. In terms of securities I do not think the world financial community appreciates the taxation of unrealized capital gains. I think they would have a feeling that it would create artificial pressures on the Canadian security markets which would make the Canadian market place singularly unattractive for investment.

The Chairman: Let us forget about that. We have heard so many representations on it, that you do not need to assume that we are not interested in that.

Mr. Van Sant: Very well, sir. The other factor is that under the integration proposals it would cause companies that do not pay taxes, and that do not have taxable income, to pay out their reported earnings. There is differentiation, of course, between reported earnings for tax purposes and stockholder purposes. In relation to companies exploring they would be forced, not having the cash, to pay out their earnings in stock in order that their shareholders should get any credit for taxes they might pay at such time as they become taxpaying companies.

This would increase the capitalization of our natural resource companies. Investors, as a general rule, do not like large capitalized small exploration companies because they have a large amount of shares outstanding. This is a factor that would hurt us.

Depletion is the other factor that would hurt us and already has. The suggestion is that it might be tampered with and has already affected the flow of funds into our industry.

The Chairman: Can you illustrate that?

Mr. Van Sant: In the case of Bow Valley Industries we have had an average of $3 million a year from outside investment. On November 7, the day after the White Paper proposals were published, those funds were cancelled and we did not get another dollar and will not until this problem is resolved.

The Chairman: That is the uncertainty.

Mr. Van Sant: Certainly until the ground rules are known they are going to hold up their investment. This is our source of exploration capital and accounts for 80 per cent of our exploration.

Senator Phillips (Rigaud): Mr. Chairman, I have this summary of the Imperial Oil recommendation to compare with that produced by these gentlemen.

The Imperial Oil summary is:

> However, Imperial's preferred recommendation is that depletion 'be implemented as a percentage of gross income from production at a rate at least competitive with the current U.S. rate, and limited to an appropriate percentage of net producing profit. This form of depletion allowance would promote exploration by rewarding successful effort rather than by subsidizing spending as the white paper proposes. It would also eliminate some of the undesirable aspects of the present system.

Then I come across this two to one business which I associate with Imperial. It says:

> Failing this, Imperial Oil suggests a transition period of 10 years, a dollar of depletion per two dollars of expenditure, and the inclusion of mineral rights and all oil and gas field development costs as 'eligible expenditures.'

Mr. Ross Chevron's recommendation is much the same, but they say that if the White Paper is implemented all current income should be subject to the current rules, regardless, which is a little different.

With reference to the exploration and development section, the way the White Paper reads it would appear that we could get around that problem of 20 per cent declining balance by merely incorporating a company and writing off the shares with a dry hole if they go through the balance of it. We just do not consider that to be the proper way, although it can be done.

Mr. Van Sant: We feel quite strongly that capital losses should only be taken against capital gains. The United States has gone

through that experience at great length. To permit the unrestricted taking of capital losses against ordinary income opens up so many loopholes that are not in the public interest that we do not feel it is appropriate.

The Chairman: And at certain times it could be disastrous for the national revenue.

Mr. Van Sant: It could be disastrous for the national revenue. It could also have a very unwarranted effect upon security prices in times of a declining market such as we have been through this last year.

The Chairman: I am interested in your word through.

Mr. Van Sant: We live in hope in the oil business.

Mr. Ross: Our recommendations with regard to capital gains tax are another feature of our brief.

The Chairman: You refer to tax-free capital gains. Do you mean by that no capital gains tax?

Mr. Ross: No, we are suggesting that a capital gains tax be imposed which gradually builds up from 5 per cent in the first year to perhaps 25 per cent in the fifth year, but would not exceed the rates in the United States at any time.

It is also recommended that a number of items would not be subject to capital gains, namely houses, art and this type of asset.

The Chairman: What about farms? We have had representations that farms which continue to be used as such even after their sale should not be subject to capital gains tax.

Mr. Ross: We feel that the sale of oil lands, mineral rights, should be at ordinary income rates. That is the current practice and inasmuch as we can deduct their costs we feel that it should be included in income.

Mr. Van Sant: We are concerned with the position of the middle range taxpayer in relation to capital gains. For instance, in the United States between 70 per cent and 80 per cent of the total capital gains are raised from people earning less than $20,000 per year.

Our examples show that a taxpayer who, for instance, has a salary of $10,000 per year, a long term capital gain of $5,000 a year and is a resident of the State of California, in the first year of implementation of the White Paper proposal on widely-held Canadian public companies would have a capital gains tax rate in Canada of 17.6 per cent. However, if he was a U.S. citizen buying a Canadian stock his tax rate would only be 11 per cent. By the fifth year, with the U.S. tax rates going down, the Canadian would pay 17.6 per cent and the U.S. citizen 9.6 per cent.

We do not believe that the U.S. citizen should have a lower rate of capital gains taxation when competing with Canadians in buying Canadian securities if in fact we are interested in having Canadians own more of their own securities.

The Chairman: There are two methods of dealing with that: the rate on Canadians is lowered or that on Americans is raised.

Mr. Van Sant: The American rate has gone up, as you know, sir, but even with that under the proposals of the White Paper Canadians in this middle income bracket would still be at a very serious disadvantage.

As a matter of fact, it is only the very wealthy Canadian who would have an advantage over wealthy Americans in buying Canadian securities. We would like to maintain and increase the level of Canadian ownership in our companies.

The Chairman: To what is this directed? Have you some suggestion with respect to this point?

Mr. Van Sant: The suggestion is if we do not tax capital gains at ordinary income rates they should be fixed rates lower than those in existence in the United States.

Senator Phillips (Rigaud): Except that you do not put it quite that way. You say you start at 5 per cent and go up to 25 per cent.

Mr. Van Renssalear: Right.

Senator Phillips (Rigaud): You do say so that it becomes somewhat lower than the effect in the United States. After all, we cannot keep track of the rates in the United States as they may vary from year to year. I take it that basically your suggestion is that we start at 5 per cent and do not exceed 25 per cent.

Mr. Van Renssalear: That is exactly the situation.

Senator Phillips (Rigaud): That is at page 18 of the brief.

Mr. Van Renssalear: The other thing in that connection is that, in our industry we

have a number of companies that would be classified as privately held companies under the terms of the White Paper. We are very much concerned that these companies would have great difficulty in getting outside financing, because many private companes do get outside financing. Our company, which started in 1949, could not have done what we have done if we had not made certain private financing deals when we were still a private company.

The people who buy securities in small companies, where there is high risk, do not buy them to get dividends, which in effect is what the White Paper says. It says in effect there should be neutrality, it should not be a matter of concern to the individual investor whether he gets his returns from dividends or from capital gains. The reality is that people investing in small companies are looking for capital gains. If they are to be treated at a different capital gains tax rate from the big companies, then that kind of risk capital will not flow into small companies, where we need the growth, and this is why we do not like integration.

Senator Phillips (Rigaud): You have introduced your brief by viewing with concern four items. One is the integration system, the other small businesses, and you mention two others. We are assuming that with the abandonment of the integration system, and the distinction that goes with it between privately held companies and all that kind of business, we are really dealing with the subject matter of capital gains tax isolated.

Mr. Van Renssalear: Right.

Senator Phillips (Rigaud): I take it your recommendations are on that assumption.

Mr. Van Renssalear: Exactly.

Senator Hays: You like the capital gains aspect, do you?

Mr. Van Sant: No, we do not.

Mr. Van Renssalear: No, we do not like it.

Senator Hays: Why did you not say so?

Mr. Van Renssalear: We do not like it from the viewpoint of Canadian ownership or from the viewpoint of general economics. We have to like it from the viewpoint of equity in this day and age. From the viewpoint of equity in this day and age it is the only justification I can see for it.

Senator Hays: We have been getting on very well without capital gains. Can you live with it?

Mr. Van Renssalear: I think Canada is one of the last countries in the world that should have a capital gains tax, because we need capital so badly.

Mr. Ross: I think when we recommended a capital gains tax, it probably was not because we wanted a capital gains tax, and it was not that we thought Canada needed a capital gains tax. We felt really that the political realities would seem to indicate that Canada was going to get one, and if it was going to get one we felt we would like to get it as reasonable as possible. It is in that context that it was recommended, not that we want one.

Senator Connolly (Ottawa West): On the basis of lean back and enjoy it.

Mr. Ross: I am afraid so, yes.

Senator Hays: But you really think you could get along without it?

Mr. Ross: I believe so, without any question, and I think we would be better off without it. Certainly at our end of the industry there is no question about it.

Senator Hays: What is the relationship of exploration drilling costs in Canada, which is a pretty cold, harsh country, with other competing countries?

Mr. Ross: I think you can even take the costs in Canada, because they vary quite materially. A 5,000-foot well can be drilled in southern Alberta for probably in the order of $40,000. In the middle of the Mackenzie it is probably up in the $400,000 range, depending on when it is done. Of course, drilling in the Mackenzie delta on an exploratory basis it could be in the $1 million or $2 million range. In the Arctic islands you can have some trouble, and it could be practically anything, as it was with that Great Point well, where they had to drill a relief well and so on.

Our costs vary all across the country. Now, as we are moving further north, exploration costs are increasing materially. It is not only the drilling costs that build up these costs. Probably only 25 per cent of the costs go to the drilling contractor; the balance goes to aviation companies, transportation companies, food, building roads and that type of thing.

We are contemplating drilling just south of Norman Wells. It would probably cost $400,000 for a 6,000-foot well on the banks of the Mackenzie. But as we move further west through the mountainous areas the cost will double if we move about 25 miles. Our costs will certainly increase very materially, and we now have to find bigger oil reserves per dollar expended that we ever did before.

The Chairman: You want to make a comparison with, say, United States prices and costs.

Mr. Ross: United States prices in perhaps Texas, Louisiana and Oklahoma, would be two-thirds to three-quarters what our costs may be. In places like North Dakota you could run into slightly higher costs than in southern Alberta or Saskatchewan.

Senator Hays: But generally costs in Canada per barrel produced are a great deal higher than in the United States?

Mr. Ross: Drilling costs per barrel?

Mr. Van Sant: No. In Canada we have almost the same spectrum of costs as in the United States, if you include our rate and theirs. The cost per barrel in Canada is less for developed oil at the present time.

Mr. Ross: You are talking about finding costs.

Mr. Van Sant: Finding and development costs, because it is the younger oil province, and it has not been explored to the extent that the United States has.

Senator Hays: But in order to find other fields this could change.

Mr. Van Sant: We are still in a younger area. We have taken pretty well the cream of the crop in Alberta. We have gotten all the cheap oil there that we know about. Now we are going into the Arctic and the Northwest Territories, and our costs are beginning to multiply very rapidly.

Mr. Ross: Even though we have a lower cost per barrel, we also have higher transportation costs per barrel and a lower price per barrel, so even though we may have lower finding costs—and we do have lower finding costs—to some degree they are offset by these other two things.

Mr. Van Renssalear: The other thing is that the locus of oil exploration in the United States is now moving into more expensive areas, offshore and up in Alaska, where they are comparable with what we are doing. There are other parts of the world where a lot of exploration is going on and they are finding big reserves. They have just made a big discovery in the North Sea, also in Nigeria and other parts of the world.

Senator Connolly (Ottawa West): In other words, the Canadian resources are very far from the markets and in the wrong place?

Mr. Ross: Yes.

Mr. Rombough: The best measure we know of cost realization is the rate of return on the industry. We know that the rate of return on the industry in Canada is not quite as good as it is in the United States.

Senator Connolly (Ottawa West): What is the f.o.b. cost on the average?

Mr. Ross: It would probably be about $2.80 a barrel.

Senator Connolly (Ottawa West): I heard a price of $2.27 about a year ago.

Mr. Ross: The price in the field of Pembina is $2.55 and the price of Mitsue is about $2.70 in the field. If you get a mixture of a light and a heavier crude the price, of course, does go down and you can get as low as $1.75 a barrel. It is about 24 gravity crude.

Senator Connolly (Ottawa West): What is the cost of Middle East oil in northwest Europe?

Mr. Ross: I would be guessing, but it is probably in the order of $2 a barrel.

Senator Connolly (Ottawa West): But it is $2.80 laid down in Edmonton?

Mr. Ross: That is right.

Senator Connolly (Ottawa West): So the export market for Canadian crude in northwest Europe is...

Mr. Ross: Practically non-existent unless you found fantastic reserves in the Arctic islands, assuming you could move it out by a tanker or some other way.

Senator Connolly (Ottawa West): Or off the east coast.

Senator Hays: It would take quite a bit of money to import it on the foreign exchange.

Mr. Ross: Foreign crude?

Senator Hays: Yes.

Mr. Ross: We are doing it currently.

Senator Hays: Are the conservation laws the same in Canada as in most countries, such as the number of wells you can put on a number of acres?

Mr. Ross: No. The main area with conservation laws which you run into would be in the United States. It varies from state to state quite materially. Their wells are probably more closely spaced than ours. Ours have moved from 40 acres to 80 acres to 160 acres as the minimum spacing pattern. In most of their states it would be around 40 acres but they would give you bonuses if you went to wider spacing. In Alaska I think the spacing pattern at the moment is 640 acres. By and large, you go to the Middle East and you have straight economics of good production practice. Conservation is only practised to a major degree in Canada or the United States.

Senator Hays: This would keep the relationship of the cost of oil and drilling substantially lower, wouldn't it?

Mr. Ross: Conservation would?

Senator Connolly (Ottawa West): Yes. If you were going to put 10 wells on 160 acres out of the same pool the conservation laws would tend to keep your costs lower.

Mr. Ross: To the degree that these foster wider spacing.

Senator Connolly (Ottawa West): Under existing laws in the United States and Canada the cost of drilling might be a great deal higher per barrel of oil.

Mr. Van Renssalear: Another reason it might be higher would be that the reserves we have been finding, with the exception of crude oil, would not be the quality of reserves found in other parts of the world.

Mr. Rombough: We know, of course, that in Alberta in the near future we will have to do a considerable amount of infield drilling in order to adequately drain the reservoirs.

Senator Connolly (Ottawa West): The f.o.b. price for crude oil in Alberta is roughly $2.80?

Mr. Rombough: In Edmonton.

Senator Connolly (Ottawa West): What about the average price in the American fields, such as Louisiana, Texas and Oklahoma, but not the offshore fields?

Mr. Rombough: It is probably close to $3 U.S.

Senator Connolly (Ottawa West): What about the relative transportation costs from Edmonton to Chicago as against Texas, Oklahoma, Louisiana and Chicago?

Mr. Rombough: Just guessing I would think from Edmonton to Toronto—Chicago would be in the 50-cent per barrel range or something like that. From Texas to Chicago it could very well be in the 30-cent range. It depends what system you use. I do not have the figures at hand.

The new pipeline system from the Gulf coast into the Chicago area is a large modern line which will handle oil much more efficiently and cheaply than any of the older systems throughout the southwest or our systems in Canada.

Senator Connolly (Ottawa West): Are we getting the modern systems installed in Canada?

Mr. Rombough: No, sir.

Senator Connolly (Ottawa West): We are not?

Senator Hays: Why?

Mr. Rombough: In future lines I think we will, but at the present time we do not have a modern system.

Mr. Ross: The fundamental problem regarding a modern system is really that in order to get it you have to anticipate future demand. You have to go to a large market so you can justify a large line. The economics of oil transportation come through sizable lines. For example, if we were to provide the Montreal market with 600,000 barrels a day and build up a trunk line to get it down there, our costs would go down materially. What we have been doing is to anticipate a little bit of demand and to add a loop here and there. Consequently, we end up with a high-cost system.

Senator Connolly (Ottawa West): Is it hard to get the capital to build up these newer lines in Canada?

Mr. Ross: With guarantees there should not be too much problem.

Mr. Rombough: If you have a supply on the market there is no problem. The original line was built to serve a much lesser market than has now developed. It has been looped and patched to accommodate the present market.

Senator Connolly (Ottawa West): Would institutional capital be available in Canada if the White Paper proposals are implemented?

Mr. Ross: I suppose if the rate is high enough, but if the White Paper present proposals are instituted the tariff will have to go up on oil pipelines because you cannot take accelerated depreciation, and probably your bond costs would be higher for a demand for money. We have not done any studies in order to know what the final effect would be, but unquestionably the tariff has to go up. If you make it attractive enough, you can probably get some of the money or outside money as well.

Mr. Van Renssalear: The end result would be the consumer would pay more for the product.

Senator Connolly (Ottawa West): That is interesting. The mortgage would be the product.

Mr. Van Renssalear: It would have to be, otherwise capital would not be attracted to the venture. It is a competitive situation.

The Chairman: There is a limit to the price in the market and you have to be competitive.

Senator Hays: Under the White Paper, in your opinion, do you think that we could keep up with the reserves which are required through the market in so far as money is concerned?

Mr. Van Renssalear: I personally do not, sir. From the experience we have seen since last November, when you consider that the independent section of the industry drills the majority of the wildcat wells and the independent section of the industry is required to go out and find its capital in the world maret place, as well as in Canada. The answer to that is that we are not going to be able to maintain this capital flow in the future, in my view, at the rates we have been getting.

Mr. Ross: I think, senator, one could call oneself lucky if one were to find a lot of cheap oil with not too much expenditure, and under our system and perhaps under any system you might very well do it. But with the experience of the past 21 years, and I think this is the only logical way we can look at it, with the White Paper proposals we would not expect to find the reserves required to satisfy the demands that we think will be there and still maintain the years of life that we have anticipated.

Senator Hays: Are you keeping up those reserves at the present time?

Mr. Ross: You cannot keep up reserves on a yearly basis, Senator Hays, because in some years you have a lot of luck and some years you do not, but overall there has been a gradual decline in years of life—that is, perhaps, an index. Our years of life are in the order of 24 years or 23 years. The Americans are down to 9 or 10 years of life. It will be a decline as we go on and we would anticipate to be down to 15 or 16 years, but we expect that under our proposal, too.

The Chairman: Is there any other point we have omitted to question you on? Is there anything you would like to bring forward?

Mr. Ross: One thing I would like to bring forward is this. The oil industry gets a lot of criticism, very regularly, on the fact that it does not pay much income tax.

Senator Isnor: Is that a fact?

Mr. Ross: It does not pay much income tax. I think we recognize that it does not. However, it makes a major contribution to the requirements of the governments at various levels for funds. During the last 20 odd years it has contributed, through Crown sales, lease rentals, royalties, perhaps in the order of $3½ to 4 billion.

I note from the Alberta brief that they expect during the next ten years, under current conditions, to get about $4 billion. If you can take past history, you would expect other jurisdictions also to get about $3½ to 4 billion. So the oil industry has made material contributions to the welfare of this country through these contributions I have indicated and it would appear that, given enough incentive in the next decade and given a lot of luck, we should be able practically to double that contribution.

I think this is an important consideration which should be borne in mind when we are looking at whether we should raise taxes somewhat and discourage exploration.

Senator Carter: The witness said earlier that the oil industry, the petroleum industry, is capital intensive. How many jobs does it represent, and what is the payroll?

Mr. Ross: Sir, I do not have those numbers exactly. We have them for individual companies here. I think that there is a general answer to your question. The oil industry directly does not employ that many people—probably 10,000 or 15,000, I suppose.

However, if you look at studies that have been made, by Professor Hansen in Alberta and updated, he indicates very clearly that the population of Alberta is currently in the order of 1.6 or 1.7 millions. And had the oil industry not been present, the population of Alberta would be less than 700,000. So the oil industry directly and indirectly is responsible for at least half the population of Alberta, close to 800,000 or 900,000 people.

If you take in Saskatchewan, you end up with another couple of hundred thousand people. That has nothing to do with the purchases which are made in eastern Canada by way of steel pipe, wire ropes and so on and the increasing percentage of our purchases are now being made in eastern Canada, of automobiles and that kind of thing.

Senator Hays: And many other things, also.

Mr. Ross: Yes, that is right. I think this is more important than the number of people directly employed.

Senator Connolly (Ottawa West): The witness has touched upon a point that has gone without much consideration, that is, that there is little sympathy for oil companies, on the alleged ground that these fellows never pay any income taxes. That is the way the proposition is put.

Mr. Ross: That is right.

Senator Connolly (Ottawa West): We have had oil companies here who have been in the business for a long time, for a good many years—we had one here last week—and they have never yet paid any income tax, though they have been here 15 years.

That kind of criticism is something we might try to deal with. I do not ask you to make a speech, perhaps other than what you have said. Certainly they are selling their stock, people are getting dividends, but the Government is not getting any and the tax "boys" viewpoint is that this is not good enough.

The Chairman: The reason they are not getting taxes is because the cost uses up so much of the earnings.

Senator Connolly (Ottawa West): I want the witness to say it. I did not want to lead him, Mr. Chairman.

The Chairman: It is not a court of law.

Mr. Ross: As I indicated in the case of our own company, we have been in operation since 1947 and we have paid no income tax but we have also invested 50 per cent more than our total cash flow. We believe that makes a material contribution to the country. Until we are actually in effect making some money, there just is no way we can pay. If we do pay income tax, obviously we will reduce the level of exploration. This has to happen, because the only discretionary thing you really have is a level of exploration. So to the degree you take money out of the stream to pay tax, you cut exploration. Therefore, we would feel that the contribution to the industry we make would be less.

Senator Hays: Would you not consider a royalty a tax?

Mr. Ross: We really consider the lease bonuses, the royalties and the rentals as taxes in effect.

Mr. Van Renssalear: Could I just speak to this in specific terms, although it may be worse in connection with our company.

Our sales last year were about $34 million, salaries and wages were $12.5 million, income tax deducted from salaries and wages was $2.5 million. We paid property and municipal taxes of $96,000. Royalties paid to the provincial government were $92,000. We paid $806,000 in land bonus claims.

This was a company that started in 1949 with three people and a capital of $5,000.

Senator Connolly (Ottawa West): You were a small company, a small business.

Mr. Van Renssalear: That is right. Until 1960 this company was a small business, not a public company.

The Chairman: If there are no other questions, I wish to thank you very much for being with us this morning and for your presentation.

The committee adjourned until 2.15 p.m.

Upon resuming at 2.15 p.m.

The Chairman: Honourable senators, we will resume. Our first submission is from Denison Mines Limited. Mr. Roman, Chairman of the Board and Chief Executive Officer, is going to make the opening statement and introduce his panel.

Mr. S. B. Roman, Chairman of the Board and Chief Executive Officer, Denison Mines Limited: Mr. Chairman and honourable senators, I know that your committee likes an opening statement which establishes the broad approach of the brief and highlights the basic positions taken in the brief. First of all, I would like to mention how Denison Mines came to submit a brief.

My early life experiences were in a very different kind of country than Canada; a country that is no longer a free country. This is something which I have in common with a great many other Canadians. My personal approach to life in Canada has been dominated by two fundamental views derived from these early experiences: the first is the importance of government in providing a framework within which individuals can be strengthened in independence rather than dependence; and, the second is that it is only individuals who can benefit themselves and their country through their own efforts, and that a society which is short of individuals strengthened in independence of thought and action is a society whose foundations will not enable it to meet the test of time.

When the federal White Paper came out last November, I asked those of my associates who are more expert in taxation matters than I, two questions: over the long run, will the proposed reforms strengthen the economic environment; and, over the long run, will the proposed reforms provide incentives to achievement by individual Canadians?

Unfortunately, the answers came back "no" to each of these questions. It was for this reason that Denison decided to submit a brief and to appraise the White Paper from two basic points of view: will the proposals strengthen the Canadian economic environment; and, will the proposals strengthen Canada by strengthening individual Canadians through the opportunity and incentive to build for the future?

We discerned six main elements in the White Paper approach to tax reform. They are: the social objectives; the equity aspects; the structural aspects; the national objectives test; the size and scope of the proposals, and, the share of national income to the federal Government.

Briefly, we are impressed by what appears to be the broad social objectives of the White Paper. But we do not think they can be successfully achieved under the White Paper approach. We think it is significant that Premier Bourassa took the same position two weeks ago in Winnipeg. In particular, we are concerned about what seems to be the serious misunderstanding of the role of capital in private hands and of individual initiative and effort in serving these objectives.

We are satisfied that the over-all equity of the tax system will be reduced rather than enhanced.

We have concluded that the proposed tax structure will be less flexible, less understandable and less durable than what we now have.

We regard the size and scope of the proposals as unmanageable.

We are at a loss to understand the absence of any effective attempt to design tax provisions that would contribute to major national policy objectives.

We were dismayed by the major tax increase implications of the proposals, a concern which is only partly reduced by the recent letter of the finance minister to your committee. There could continue to be a basis for automatic revenue increases beyond the five year period covered by the letter.

Mr. Chairman, I do not know how your committee would prefer to discuss the brief. Possibly you would like to follow the order that is taken in our brief. First, we established the broad perspectives for tax reform in the seventies. Then we appraised the six main elements of the White Paper approach, followed by a specific examination of capital gains, corporations and their shareholders, international aspects and the mineral industries.

I would like to highlight our approach to capital gains and to Canadian ownership, and I hope we can get into these two vital questions in some detail.

First, on capital gains. Our attitude toward the taxation of capital gains is based on the view that capital and income are not the same thing; that the creation and preservation of capital can be a powerful motivation to savings, innovation and enterprise; and that capital has been and is our essential source of

economic growth and thus individual well-being. Canada still needs the dynamic risk-taking and capital formation which the tax-free treatment of capital gains has provided. Tax-free capital gains have been a dynamic element in promoting Canadian growth in competition with the huge economic power of a capital surplus United States. It is a form of policy bankruptcy to be espousing a policy of more Canadian enterprise for Canadians, while reducing through higher taxation of risk and capital the incentive to do the job and the savings available for the job.

Second, on Canadian ownership. Canadian ownership will not be advanced by any of the provisions of the White Paper. It will be retarded by many, especially by the adverse savings effects of the capital gains tax and the elimination of recognition of small business financing problems, and by the negative proposals for mining and Canadian-based international investment.

Our political system will survive only through the increasing direct participation of citizens; equally, our economic system, on which our political system rests, will survive only though full economic participation by more and more Canadians. Decentralization of capital in the next decades must match the centralization of capital in the past decades, if our free society is to remain viable and its balance restored.

This can only be achieved by emphasizing the creation of capital and savings by individuals. It is vital that every Canadian appreciate that his income today can become his capital tomorrow—if it is saved. This means encouraging, not penalizing, the individuals who save. There is no other way for Canadians to own more of Canada.

Our brief contains a number of positive proposals based on these requirements. We believe their adoption will strengthen the economic environment, which is the foundation of fairness for our people. We believe their adoption will also provide incentive for Canadians to build for themselves and the future of Canada.

Thank you. We will now be happy to answer your questions.

I would like to introduce my associates. Mr. MacDonald from McMillan, Binch. Mr. Bruce McConkey, our Vice-President, Finance and Treasurer, and Mr. Parmelee.

The Chairman: Senator Phillips.

Senator Phillips (Rigaud): Mr. Roman, in some of the questions I propose to put to you I would like to state the following: when the honourable senators here do not necessarily follow the format of your brief and the importance that you place on the significance of social matters, equity and structural changes, and the like, it does not necessarily mean that we are not responsive to the argument. But it does mean that, after having listened to a great number of briefs from across the country, there are certain aspects of the White Paper in the representations that have been made to which we are already sensitive, and if they are not necessarily discussed by my colleagues, it does not mean that we are not studying them carefully.

Therefore, you might find that in our reaction to your brief we may be picking up some of these questions not necessarily in the order of the format of your brief because we are seized with some of these matters that may have been raised in other briefs. Because you may find me jumping to the latter part of your brief rather than the earlier part, I felt that this explanation was necessary.

Now, with that background, would you be good enough to turn to page 42 of your brief, possibly going back to page 41? As far as I am concerned, as one of the members of this committee I am impressed basically by two contributions that you are making to the White Paper debate in dealing with the natural resources industry. That is on page 41 of your brief. Paragraph 6.6 of that section states:

> Here are four key factors about Canadian mining in the seventies:—

and you mention the four items which I will ask the stenographer to introduce, so that I will not waste time in reading them.

> —metal ore reserves are now more difficult and more expensive to find in Canada than in countries like Australia, and are usually lower grade as well;
>
> —Canadian developments are usually in remote areas and have a very high capital cost;
>
> —radical reductions in ocean transportation costs are not matched by reductions in Canadian railway or lakeshipping costs, thus shifting the international competitive balance from Canada; and
>
> —the regions dependent on Canadian mineral industries cannot, because of

their lack of a broad industrial base, afford to have mining activity decline.

The White Paper refers to the fact that the natural resources industries are entitled to incentives, but the incentives should be reduced rather than maintained, leave alone not increased. I, for one, am impressed by the key factors which you say are present in the seventies which involve at least the maintenance of the present incentives rather than their reduction.

Honourable senators will be reading paragraph 6.6. Each one of the four items, I think, is of basic importance but not quite developed to the point you have developed it in your brief, at least in seriatim form.

Having said that, I would like to move to page 42, paragraph 6.12. The last part of that paragraph intrigues me, which states:

> The value of the present incentive provisions is estimated to drop under the White Paper by up to 75 per cent for mining generally and by 85 per cent for iron ore mining to feed the Canadian steel industry.

My question is: have you any working material to justify these mathematical conclusions?

Mr. W. A. MacDonald (Partner, McMillan, Binch, Denison Mines Limited): Senator, the reference there is to mining generally.

Senator Phillips (Rigaud): Do you mean on page 41?

Mr. MacDonald: No, I am sorry, up to 75 per cent.

Senator Phillips (Rigaud): For mining generally.

Mr. MacDonald: Yes, for mining generally. This was based on our knowledge of what the International Nickel Company is saying about its operations. They were here, I think, a week ago. I think they were very close, as I recall, to 75 per cent, and the Mining Association, in which this company participated, had figures of the same general order of magnitude.

In the case of Iron Ore Mining for the Canadian steel industry, I was personally involved in the work that was done in preparing their submission to your committee and I know that they have working papers for four or five possible projected mines that the three Canadian steel companies are looking at at the present time. This has averaged out, as I recall it, that they would retain about one-sixth of the incentives which, I think, works out to about 85 per cent.

Senator Phillips (Rigaud): Right. With the permission of the Chairman, when the submission was made by the Iron Ore Mining, were their scheduled projections in support of the 85 per cent diminution in incentives, or was it a conclusion? I am not questioning the validity of the conclusion, but I am wondering whether there was supporting documentation.

Mr. MacDonald: For my recollection, senator, I looked in another senator's office before we came here to see if I could put my hands on the proceedings of this committee for the particular day when the three steel companies appeared. Unfortunately, that happened to be the only one that was missing, for what reasons I do not know, but that is usually, I suppose, the way it is.

I have a firm recollection that one of the witnesses referred to the retention of only one-sixth of the benefit. Now, I know that that material was not part of any of the scheduled material that you had. I might say, although the gentlemen are not here, that I have heard that they wish to make available that material to the committee if it will assist you.

Senator Phillips (Rigaud): Will you give me your status again, please? You will see why I am asking that. You are Mr.?

Mr. MacDonald: I am Mr. W. A. MacDonald.

Senator Phillips (Rigaud): You are a partner of one of the leading firms in Toronto, of which I am aware, McMillan, Binch.

Mr. MacDonald: You do not expect me to comment on that.

Senator Phillips (Rigaud): I suppose our Chairman would not mind me saying that. Are you prepared to state, as a lawyer from one of the important law concerns—I think one of the leading law firms in Toronto—that, with your experience and your association with this submission, you do not regard that statement that the present incentives would drop to 75 per cent for mining generally and 80 per cent for iron ore—as a colleague at bar, are you prepared to state that that is a responsible submission to a fellow Canadian and a fellow barrister?

Mr. MacDonald: I certainly believe that I would act on that basis myself.

The Chairman: Senator Phillips (Rigaud), could we break it down a little? The mining industry at the present time—those who have already spent their tax holiday only have the depletion incentive, and that depletion presently is 33⅓ per cent of their net production income.

Senator Phillips (Rigaud): Yes.

The Chairman: Now, what you have to do is to translate that into what you would get from each dollar bonus for every $3 that you spend.

Senator Phillips (Rigaud): Yes.

The Chairman: I do not pretend to be that kind of a mathematician. I think some people who have appeared before us have indicated that there would be a substantial reduction.

Senator Phillips (Rigaud): I find the figures, Mr. Chairman, dramatic.

The Chairman: I have sent for a copy of the hearing so we should have them shortly.

Senator Phillips (Rigaud): Because I find the figures dramatic, and I am sure that my colleagues must respond, and because we know that the incentives would be substantially reduced under the White Paper proposals, I must confess that I never realized that the drop in respect of the mining industry, exclusive of iron ore, would be that precipitous.

The Chairman: There are a lot of factors you have to look at. If the only thing you are looking at under the White Paper is earned depletion, then the only way you can earn it is by exploration and development. You have to bring in all the factors.

Suppose we take an operating company which is earning money. The question is: what is the difference then? One thing depends on the stage at which they are at, and the amount of exploration and development they need to do.

Senator Beaubien: Mr. Chairman, did not the Iron Ore people say that the exploration was all over—that it had already been done? So they would not get any depletion.

The Chairman: No. That was very simple. They have iron ore available for the next 100 years and therefore they said there was no need for them to spend any money on exploration and development, and that they were not going to do any exploration. Therefore,...

Senator Beaubien: They would lose the 33⅓ per cent.

The Chairman: Therefore, the depletion under the White Paper does not mean anything to them.

Now, the tar sands people, which is a mining operation, have the same problem. They are in the same position. They have no exploration and development and therefore they cannot earn any depletion, and so there is no incentive.

Senator Cook: Do the words "to feed the Canadian steel industry" have any significance?

Mr. MacDonald: The significance, senator, of course, is that there is substantial iron ore mining for export to the U.S. steel mills, and because of the structure of the depletion and tax holiday provisions, the provisions are of greater value to Canadian steel mills than they are to United States steel mills. The significance is that 85 per cent is a figure that we can stand behind as a principle or use for Canadian steel mills.

I personally could not, nor do I think our group could stand behind what that figure would be for iron ore that is being mined for export. These people will have to speak for themselves; I take it that they have, in fact, been here.

Senator Cook: I want to know whether or not you think domestic iron ore was treated more severely, and whether it would lose more under the revised proposals than ore that was mined for export?

Mr. MacDonald: Frankly, I would not like, without access to the figures, to estimate or to say what that might be, but at 85 per cent you are getting very close to 100 per cent, and it could not be very much more.

Senator Beaubien: Mr. MacDonald, even though the iron ore company exports pretty nearly all of its iron ore, it makes no difference in Canadian taxation law whether any of that is to be consumed in Canada or the States.

Mr. MacDonald: Senator, in explanation, the depletion goes through for all mining to what is called prime metal. That is the pure state of the metal. In the case of the steel industry the purest state, before it becomes

converted into steel, is pig iron or hot metal. You reach a pig iron or hot metal stage in Canada with the Canadian steel mills, but you do not go that far for iron ore that is being exported to United States mills. Therefore it is either iron ore or pellets that are exported, which is an earlier stage of beneficiation. One might well suspect that the Canadian steel industry was going to be harder hit simply because it is being bumped over a further step in the processing.

Figures are funny. Without looking at the figures I would not really care to say, although I do gather it is pretty devastating for the export iron ore just as for iron ore to be used in the Canadian mills.

The Chairman: It is bound to be if there is no incentive.

Mr. MacDonald: I do not want to recall previous evidence, but the Hamilton producers who have American partners in the Wabash development suggested that, even under the White Paper and what was simply an incremental expansion rather than a brand new development, they were finding it hard to interest their American partners.

Senator Burchill: On page 41, paragraph 6.6 you say:

> Metal ore reserves are now more difficult and more expensive to find in Canada than in countries like Australia...

Are you referring to base metals?

Mr. Roman: Base metals and most any other metal. We are looking for ore in a certain terrain and geological area.

Senator Burchill: The Australian mining industry is making greater progress than we are here in Canada?

Mr. Roman: I would say that in the last two years Australia mining industries have been making tremendous strides ahead. In Canada, senator, you must remember that for years we had a very healthy framework for development of new deposits. As I have mentioned on many other occasions, Canada is the only country in the world today that produces below one-half of one per cent copper which otherwise would remain in the ground as just rock for the next 1,000 years.

We are deriving national capital, and creating employment and establishing secondary industries with the mining of low grade ore.

Mr. MacDonald: May I add a comment on the Australian subject. I do not know whether the senators have seen the extremely interesting Bank of Nova Scotia Monthly Review on the Australian mining industry. In terms of the alternatives that are now available to international mining capital, it is certainly a particularly interesting and concise statement of the advances in Australia during the last short while.

Senator Phillips (Rigaud): I think it was incorporated in one of the briefs, Mr. Chairman.

Senator Burchill: Does the article compare the tax laws and the mining industry in Canada with Australia?

Mr. MacDonald: I cannot recall. You have seen the international nickel comparison, which I thought in many cases was the most definitive comparison I have read—and not entirely cheerfully either.

Senator Cook: On page 41, paragraph 6.6 you also refer to the development costs:

> Canadian developments are usally in remote areas...

Would the effect of it being in a remote area add to the operational costs, apart from the costs of interest on capital? Would being in a remote area add to the operational costs to the mine?

Mr. Roman: It definitely would, because in certain areas of Canada you have to pretty well operate on a basis that is compatible with those particular regions. As you go in a more remote area it is difficult to get labour, more expensive to bring the supplies in and it also adds up to greater costs.

Senator Phillips (Rigaud): In dealing with the subject matter of depletion and tax holidays, we have had the following thoughts introduced before this committee, accumulatively from prior representations. One, that the mining industry presently in production is entitled to consideration in terms of the retention of the present incentives in the field, that long-term financing was based upon the incentives with all the implications of cash flow and all the factors associated, and that there would be a breach of faith with investors in Canada which have nothing to do with the ultimate profits made by the mining companies but rather in relationship to the investor. Therefore, the suggestion was made that, with respect to current mining operations, the present incentives be continued.

Two, the suggestion has been made that with respect to pushing the frontier northward, eastward, westward, and so on—I believe it was the Inco brief that introduced for the first time the phrase "pioneer areas"—that special incentives should be made available for the so-called pioneer areas on the assumption that the same would be properly defined.

I notice that your brief, as distinguished from other briefs, does not give alternative suggestions other than those contained in the White Paper with respect to tax holidays and depletions. Other mining briefs have, and I thought you might want to react to these three headings.

Mr. Roman: Can I answer your last question first?

Senator Phillips (Rigaud): It does not make any difference.

Mr. Roman: We decided to make our brief philosophical rather than provide alternatives. We realized that there would be many other companies presenting the alternatives and paying quite a bit of attention to the specifics, because I do believe that every human undertaking must be based on some kind of a philosophy. That is why this brief is presented the way it is.

Senator Phillips (Rigaud): I should not interrupt you, but philosophy sometimes leads to the drinking of hemlock. That is what happened to Socrates. We must get beyond that and get to some specifics.

The Chairman: Let us not recommend it, though.

Mr. Roman: I do not see any society advancing without specific philosophy to follow. Whether that particular philosophy is constructive and properly formed to advance what we want to advance, in other words, whether a strategy is proper or not, we cannot prove that strategy for the future, or today's strategy, that it will work in the future. All we can do is act on the negative part, on that what was established in the past either worked or did not work, and apply a certain amount of judgment, which you know much better than I do, whether the particular strategy that you are advocating is bound to work or fail. That is the reason for this brief being prepared as it is.

The Chairman: There are some questions I want to ask Mr. Roman. What were the earnings of Denison during the tax holiday period?

Mr. E. B. McConkey, Vice-President, (Finance) Denison Mines Limited: During the tax holiday period the reported earnings of Denison were some $34 million.

The Chairman: What was the capital input to bring the property into production?

Mr. McConkey: In a range of $55 to $60 million.

Mr. Roman: I think it is more than that—more like $65 to $70 million. It may be I will get to argue on that.

The Chairman: The mining association made a suggestion that the only limitation which they thought should be made on the tax holiday would be that if the capital input were recovered in less than three years the holiday should cease at that time. They would not go so far as to say that was the consensus but it was expressed as a viewpoint. Have you any comments on that?

Mr. Roman: I definitely have. I think you are leaving the legislation open for something we are trying to avoid—different people designing a different system and different approaches that are not definitive enough for legislation. There are always some people who will say that this goes into this area and it is part of putting it into production, while other people will say otherwise. I am going back again to my philosophy. I like to have everything established in such a manner that there is no argument later, there are no loopholes or possibility of loopholes. So if you make a statement that the legislation reads that it is a year or three years or five years, you know what you have.

The Chairman: They are proposals, and I am trying to get your assessment of it. The proposal was that you have a three year's tax holiday but if you earned your income in two years of the tax free period, the holiday stopped. You got your write-offs of course.

Mr. Roman: I do not want to be cynical or go contrary to the Mining Association's proposals but there will be very few mines which would recover their capital in less than three years.

The Chairman: That is what struck me, that they are the rare cases.

Mr. Roman: Very rare.

The Chairman: Another point voiced was by way of criticism, that if you have a tax free holiday of three years and you have earnings which are tax free in that period, and you do not make any write-offs during that period, so the net and the gross are the same, then at the end of the three years you start writing off pre-production expenses, and so on, you really reach a period of about seven years, another three or four years, before you begin paying any taxes. What is your comment on that?

This has been voiced by way of criticism. I have an idea that this may have been what the authors of the White Paper were thinking about when they expressed the view that the mining industry, while it is entitled to an incentive, may have been getting too much.

Mr. Roman: Too much incentive?

The Chairman: Yes.

Mr. Roman: Presently we have in Canada a mining industry, one of the best in the world.

The Chairman: That is right.

Senator Phillips (Rigaud): For whom, Mr. Roman? For the Government, in terms of revenue or for the shareholders in terms of dividend?

Mr. Roman: For the people of Canada.

The Chairman: That is the basic question.

Mr. Roman: For the people of the country. You do not find many places in the world where low grade ores are mined that are mined in Canada. That must indicate something—the knowledge of the people and also some kind of a framework within which a mining industry operates that makes this possible. If we kill this particular incentive, we will lose a lot more than it seems on the surface at the present time.

There is an argument—which is more necessary for a mining industry, a tax free period or depletion allowance? In my opinion, they are two entirely different things. If you are going to kill it, or if the legislation will not provide for a tax free period, you will find, for bringing into operation very few mines in the future, unless they are of a certain grade that is economic.

On the other hand, the mines that are now established and are producing, obviously for them it is much better to retain the depletion allowance.

Senator Phillips (Rigaud): Mr. Chairman, may I put this question. Mr. Roman, we are not dealing with the question of the desirability of incentive: we are dealing with the degree thereof. Even the White Paper admitted the necessity of incentive. So all these discussions and repartee are within the fringework of the degree of incentive.

The suggestion has been made that with respect to depletion, a time period be placed, say 21 years and call it a day, applicable to all mines, in so far as depletion allowance is concerned as a deduction from income. What is your thought on that?

Mr. Roman: I have nothing...

Senator Phillips (Rigaud): You have no reaction or thought, as to what would be the effect? There are so many mines or so many companies, or so it is alleged, who are getting deductions by way of depletion which is tantamount to subsidy in that sense.

The Chairman: There is one big difference. They have to earn it. The subsidy comes from tax on all the people.

Senator Phillips (Rigaud): That is true but in relationship to the depletion, the feeling is that the life is such in certain instances that a reasonable time period should be related to the depletion allowance. I am only trying to get your reaction to some of the suggestions.

Mr. Roman: My first reaction to this, and I must admit that it is quite weak, is that we operate within the sphere of a free world and I think we have to relate our own particular advantages and disadvantages with regard to these other people, what they can do and what we can do.

If the environment is more attractive here, it makes Canada much more viable and much more competitive in the world.

Everything in our economy, as you know, is very relative, and it just depends, whether we have to compete, with for instance, Japan in certain matters or whether we have to compete with some eastern European countries. One does not compare with the other. We have two parallels at that time. With one we can compete pretty well in any way at all but on the other side, going to Japan, we will have to work really hard and be productive in order to be able to compete with them. I think we should relate it to the sector or to the area in which we are operating, and keep in mind that we have to compete with them.

Senator Phillips (Rigaud): The basic reasoning for incentives is based upon two facets: one, the necessity of pushing the frontier back and finding natural resources and, two, the commodity is a world commodity and you have to compete in the world markets.

The Chairman: Yes. You have really put your finger on it, senator. Practically all of the minerals produced in Canada are exported.

Mr. Roman: That is right.

The Chairman: Therefore you have to compete in the world markets with the other parts of the world where the same minerals are being produced. There is no national characteristic to minerals. They occur in all sorts of places.

Mr. Roman: There is one thing I would like to point out, and that is that our governmental framework and the framework that was worked out years ago for the mining industry are very necessary for keeping our capital in our country and for bringing in additional capital for expansion, which you referred to as pushing our frontiers back.

Remember that we sometimes overlook or get a little bit carried away with our natural resources. But we are not the only country that has natural resources.

Take, for example, a country like Brazil. With a little more responsibility—and I am not criticizing the government—and with a different environment in the country, people could go there with a little more confidence. They have everything we have, perhaps in larger quantities and of a little better grade.

Senator Phillips (Rigaud): They have great minerals and great emotions at the same time, too.

Mr. Roman: Yes, exactly.

Senator Beaubien: I would like to ask Mr. Roman a question about the 21 years depletion. Would it not be that International Nickel's main mine would not have earned any depletion for 20 or 30 years and therefore they would not be mining it anyway?

Mr. Roman: Well, that is true, but, again, because of the grade of the ore bodies, sometimes a particular depletion is necessary in order to make a viable thing out of it.

Mr. MacDonald: May I make a comment, Mr. Chairman?

The Chairman: Yes, of course.

Mr. MacDonald: I think one of the problems with which we are always faced is the time at which a particular decision is being made. There is a lot of tension put on the time when a decision is made to develop or not to develop a particular discovery because it is easier at that time to at least get some figures. You have some idea of what you have found and you have some idea of what the world price might be and you have some idea of what the capital costs may be. But you push for the earlier decision, which is much more difficult to assess, of how people are going to react; that is the exploration point decision. That is the decision as to whether you are going to explore, and how much available money you have to put into a particular area.

That has to be, in my view, related to the value of what you may find, and if the values in general are substantially reduced, then the interest in making that initial exploration decision has to be reduced. We would then envisage an accumulated effect.

At the other end of the scale, this 21-year end—my associates are better able to speak on this than I—I know, for example, of an old coal mine in West Virginia that finally, through a slight increase in wages, ceased to mine because they had then reached the point where the grade was getting lower and lower, and it did not take very much in the way of increased costs—and this would be my concern—to cause it to cease operations.

I think it is logical that, if you were starting today, you would say: would it matter whether or not I put my money out for a mine 21 years from now? You would probably say: 21 years is so far away that it wouldn't make any difference on the decision I would make now.

But in 21 years from now it may make a difference in whether or not I can operate that mine.

The Chairman: You have to deal with the present. It seems to me that before you develop a property there is a feasibility study.

Mr. Roman: Yes.

The Chairman: And the feasibility study involves all the known factors and projections that can be made, and on the basis of that they determine whether the operation will be economic.

Now, having made that decision at that time on the basis of known incentives, can you suggest any reason why these known incentives should be removed or reduced simply because the operation has been more successful than they thought it would be?

Mr. MacDonald: We certainly could not suggest any.

The Chairman: Or because the international market price for the product went up and made it more profitable?

Mr. MacDonald: No. I do not suppose that those for whom the market price has gone down are in any better position to request some new concession.

The Chairman: The language of the White Paper is very interesting. It tells you what a wonderful industry the mining industry is. It tells you what wonderful things it has done for Canada, but then it says that it is getting a little too much in the way of incentives.

Now, how do you translate this thinking? On page 64 of the White Paper proposals it states:

> It is recognized that the exploration for and development of mines and oil and gas deposits involve more than the usual industrial risks and the scale of these risks is quite uncertain in most cases.

That is an accurate statement, is it not?

Mr. Roman: Yes.

The Chairman: Then it goes on to say:

> Consequently, special arrangements are desirable to ensure that the costs of exploration and development may be charged for tax purposes as early as possible in order that taxes will only be applied when it is clear that a project will be profitable.

What comment do you have to make on that? I have some reservations. What have you to say?

Mr. Roman: What do I have to say?

The Chairman: This is on page 64, paragraph 5.24.

Mr. MacDonald: Is this what you are referring to?

> Consequently, special arrangements are desirable to ensure that the costs of exploration and development may be charged for tax purposes as early as possible in order that taxes will only be applied when it is clear that a project will be profitable.

I suppose up to that point one would have no quarrel with that statement.

The Chairman: No, but the statement...

Mr. MacDonald: One could not be unhappy about not having taxes applied before it is profitable. It is perhaps when they go on that one becomes unhappy.

The Chairman: Well, the statement leaves some things unsaid.

Mr. MacDonald: I would agree with that.

The Chairman: It goes on to say:

> Secondly, it is recognized that the exploration for and development of mineral deposits continue to provide special benefits to Canada and to various provinces by creating or maintaining highly productive industry in areas other than those where rapid urban and industrial growth are already occurring as a result of both private and public efforts.

There is no doubt about that.

Mr. MacDonald: No.

The Chairman: All you have to do is to look at the Labrador development, the tar sands development and the Arctic Islands oil exploration. They go on to say: that it is felt that incentives should be more closely related to the activity.

Mr. MacDonald: I would love to comment on that!

The Chairman: Go ahead.

Mr. MacDonald: I think that what the three-year holiday and depletion does is to increase the value of the discoveries. I cannot think of anything that is more directly related to what people do and what they are prepared to spend money on than the value of what they hope to get as a result of doing so.

I think this is the fundamental misconception in the entire White Paper approach to incentives.

They have the idea, if I may put it this way, that everybody is sitting on the margin and basically saying: if someone would only pay an extra penny or two of my costs, that is all I need to get moving. I do not believe

that that is the way people are motivated in this world. I think there is nothing more direct than the way the present incentives operate.

The Chairman: What would your position be, Mr. Roman, if the tax holiday period were continued with the provision that some portion of pre-production expenses be written off within that period, say, 5 per cent a year?

Mr. Roman: Well, it depends again, senator—you have to relate that to the type of grade of the mine. That is, if you have a higher grade and your three-year tax period is substantial, maybe you will not be hurt as much as the person who is striving to bring into production something which is very marginal.

The Chairman: That is looking at it from the point of view of the mine. Looking at it from the point of view of the people, who put up the risk capital,...

Mr. Roman: Well, again, you must go into a little philosophy here. The White Paper seems to always forget the people who lose money or who are trying all their lives and come up with nothing, and once somebody comes up with something, all of a sudden the whole image changes and—for lack of better words—it belongs to everybody at that time. Everybody in Canada is free to go and explore and prospect and live in the bush, but not everybody is willing to do so.

The Chairman: We had some copper people here from British Columbia who are working a property which had been worked by a number of people who turned it down over a period of perhaps 30 years. It was not a feasible operation, but the people who appeared before us kept at it and finally got the Japanese to underwrite the cost of putting up a mill. They got into production and had a market through contracts with the Japanese. They told us that in eight years they paid off the whole capital cost of the operation. Now, somebody must have been taking an awful risk at quite a number of stages.

Mr. Roman: That is right.

The Chairman: They took that long and the history of many successful mining companies—I can name a number of them myself—is that they had been kicked around for 10, 20 or 30 years until suddenly some person came along with a little different idea about what might be done and you have a mine.

Mr. Roman: Yes.

The Chairman: That emphasizes the risk, and the White Paper agrees that there is risk. But they are trying to translate it into less dollars than that provided by the present formula.

The international format for risk capital in mining is such that they look for a tax holiday and depletion. Can you borrow money without it?

Mr. Roman: Not, again, for certain types of deposits, no. I think the Canadian modus operandi with regard to mining should be to get as many deposits brought into production as soon as possible because we are worrying about regional development, and I think mining is one of the greatest assets we have to regional development.

Senator Phillips (Rigaud): Suppose, Mr. Roman, that if I were Minister of Finance—which I never hope to be...

Mr. Roman: I think you would make a good one, senator.

Senator Phillips (Rigaud):... and I were to say to you, "I do not like the present depletion system; come up with an alternative one that will not hurt the industry too much in relation to the international markets and everything that we have discussed here today". What alternative would you come up with?

Mr. Roman: I think you would have to give me a day or two to think about it.

Senator Phillips (Rigaud): Of course. As I said before, my concern about your brief is that you are assuming that we are living in the best of all possible worlds. I find it difficult to elicit from you an alternative approach to the depletion, either by accepting that which has been given by the Mining Institute or by International Nickel or by any other concern; so, having failed in my effort in that respect in all three questions I put to you, I am asking you specifically: suppose we were drafting an alternative for this committee, rather than a continuance of living in Elysian Fields, or any place which pleases you; the Minister of Finance says, "You are not going to live in the Elysian Fields." He is going to move you over to the next field. What then is your alternative formula as the next best way of life?

Mr. Roman: First of all,—I will let you answer in a minute.

Senator Phillips (Rigaud): We are looking for guidance.

Mr. Roman: We are assuming that we must change something for the sake of change. Is that what you are saying?

Senator Phillips (Rigaud): Yes, that is right. By way of reduction of present incentives. Forget about the tax holiday.

Mr. Roman: I would be a very poor person ;o answer that question for the simple reason :hat I believe incentives are tied to human beings to such an extent that I would want to ncrease the incentives rather than decrease ;hem.

Senator Phillips (Rigaud): Increase the ncentives rather than decrease them.

Mr. Roman: Yes.

The Chairman: So if you were given the :hoice—they have said they will make it ower—you could make it higher.

Mr. Roman: I would make it higher.

The Chairman: Well, that is human nature.

Senator Hays: Where else do you think eople could be better taxed? A propos of ;enator Phillips' (Rigaud) question, what do 'ou think is a better format for taxation?

Mr. Roman: Do you mean, where the Gov-rnment can find more money? Is that what 'ou are asking me?

Senator Hays: Yes.

Mr. Roman: I would say that by creating 1ore, by giving more incentives, it would roduce more. You would be able to tax more ecause, obviously, if you discourage and kill 1centives to produce—today you may have to aise taxes by 10 per cent, but tomorrow, if ou are not producing, you will have to raise 1e taxes again.

Senator Phillips (Rigaud): May I ask Mr. .oman, that if you increase the incentives, re you going to increase the taxes?

Mr. Roman: No, no, senator, I would not gree with that logic. I would say this: I 'ould increase the incentives to the point here the result would be much greater than hat it is at the present time.

Senator Phillips (Rigaud): That was an 1favourable remark and I take it back.

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The Chairman: Do you mean that more people would dig in?

Mr. MacDonald: May I just add a comment, senator? While we accept that kind of comment from the likes of Mr. Roman, it was interesting that Premier Bourassa in the course of his statement two weeks ago with respect to the mineral industries did suggest that his proposals might, in the first instance, reduce revenues but that the end result would be to increase them.

Senator Phillips (Rigaud): The Ontario brief said the same thing.

Mr. MacDonald: Ontario does too. I suppose that the problem Mr. Roman has, and I must say that I share it, is that if we are thinking about what is going to be good for the country, it is hard to suggest something we think will be less effective than what we have, and that, frankly, is the difficulty that we have.

Senator Phillips (Rigaud): In other words, you say the status quo, based on the experience we have, should not be disturbed.

Mr. MacDonald: In this particular case. I do not know that either Mr. Roman or I are great "status quo" people, but we have something that has been working well.

The Chairman: Well, it is obvious that in relation to depletion we are going to have to do something because depletion is placed only on earned depletion and you have companies in the mining industry that cannot earn depletion. Yet, if they are mining companies, the White Paper says they are entitled to incentives.

As I construe an incentive, it means you pay less taxes. That is the only interpretation I can put on the word. Then we are going to have to divide up the depletion so that those who cannot earn depletion will still get some unearned depletion.

Mr. Roman: But, senator, you have to be very careful not to subsidize the inefficient. You see, it is a very, very delicate matter to go from the point of incentives to the point of subsidizing something that, had the subsidies been avoided, the operation of itself would have been there...

The Chairman: I am not talking about subsidy. Remember, the basis of these incentives is that you must earn them.

Mr. Roman: Yes.

The Chairman: So, if it is an inefficient operation and it does not earn anything, you are not concerned about depletion. They get nothing. I am not talking about subsidy. Remember, the basis of these incentives is that you must earn them. If it is an inefficient operation and does not earn money you are not concerned.

Mr. MacDonald: Senator, can I make a comment on that. We have the most interesting twist in the White Paper thinking. Surely the way that you earn whatever incentives there are is by going out and spending money on exploration and development and creating a new mine and all that goes with it. Surely at that point you have earned it. The implication seems to be having earned it that you must earn it again by starting all over. I think that that is what Mr. Roman means by having spent money wisely and having created something that is profitable. In order to gain the benefit of what should have flowed from what you did you have to start out and look for something else to do, which may or may not be a sensible thing.

Senator Phillips (Rigaud): It is not quite that simple. What you have earned is a capital asset rather than dollar income as a result of incentives, and you still have the capital asset. That raises the issue as to the life of the depletion allowance. True, the incentive you have earned is something, but the earning is not a dollar earning—it is a discovery of the capital asset. The issue is to what extent you have the right to use that, as depletion income, to reduce earnings on the use of capital assets you have discovered. You have not discovered it, but you have uncovered it.

Senator Beaubien: That is wasting capital asset.

Senator Phillips (Rigaud): On the question of wasting capital assets we are back to what is a reasonable life for depletion. We are back to where we started.

The Chairman: The original concept of depletion is that it is a wasting asset. This is still the concept in the United States.

Mr. Roman: May I expound for two minutes? As I said yesterday, and I will repeat, I know exactly what you are driving at, but you cannot do it by picking up specific issues within the framework in which you work. You must revamp the framework. Revamping the framework is not revamping the tax structure, but revamping society. I definitely believe that from the ashes of our society, or from the ashes of the Communist society, in 30 to 50 years you will have one that is completely incentive orientated. That is where no squeeze capital will come from labour of from the Government. Labour and capital will work together for better and more efficient production. I am taking into account primarily human beings.

As I stated before, I know what is is to stand in front of a machine for eight hours and watch a few things being stamped out. You keep watching the clock and it goes so darn slow that sometimes it drives a person out of his mind. I believe that that particular person should be tied to some kind of an end result of his production; in other words, some kind of a society which will be so incentive orientated that every labourer is directing himself on one side and somebody providing capital on the other side so that they are working as partners rather than opposing each other.

The Chairman: Except, Mr. Roman, our position now is that we are considering proposals in the White Paper and they do not give us any room to philosophize. We have got to say what we think of the depletion proposals in the White Paper. We are trying to get ideas from the industry and we have had quite a cross section of them. I would think we have shaken the thing pretty well today and we might now move on to the next item. What would you suggest, Mr MacDonald?

Mr. MacDonald: We would like to deal with those areas of principal interest to your committee.

Senator Hays: Can we deal with capital gains, Mr. Chairman?

The Chairman: I was waiting for you Senator Hays, because that is your favourite subject.

Senator Hays: I would like your thinking on capital gains. I said this morning, when you were not here, that it took us almost 400 years to reach $42 billion gross national product, and in 10 years we have almost doubled it under the present system. I would like to know what your thinking is on capital gains. Of course, I am wholly opposed to capital gains in Canada.

Mr. Roman: Senator, I think you know my views, and it is reflected in this brief too. If today I deny myself something in order to save $10, and Bill MacDonald goes out and spends $10 foolishly, it is his privilege as a free individual. But if I deny myself something and put my capital into the economy to provide jobs and opportunities for other people to get started, why should I be taxed on whatever that capital earns?

The Chairman: We have moved a little beyond that. There is a capital gains tax proposal in the White Paper which is correlated to income. We have had quite a volume of opinions here. One is that if you must have a capital gains tax it should be a separate tax and not related to income at a specific rate, and that you distinguish between long-term and short-term gains. Short-term gains or the fast buck, as I call it, would be income, and the long-term gain from a longer holding would be subject to this fixed flat rate.

The stock exchange representatives who were here this morning told us that actually a dividend tax credit on a sliding basis would produce a plusing in tax revenues, whereas the integration proposals and capital gains would to some extent produce a minus. It may well be that a capital gains tax correlated to income is the wrong way of doing it. You have agreed with that because you said a capital gains tax is entirely distinct from income and should not be related to income. You move up to the next step.

If a capital gains system is inevitable, is the preferred plan a flat rate that has no relation to income?

Mr. Roman: Mr. Chairman, you are already assuming that capital should be taxed.

The Chairman: I am asking you to assume that because I think it has got beyond the stage of economics or the viewpoints of individuals. There is a general public which is looking to it as a source of income and a source that should be taxed. If you take that as your basis then you are going to have to face some kind of capital gains tax.

Mr. Roman: First of all, in a country such as Canada capital gains should not be part of our system. Secondly, if it comes and it has to, because it is a political decision and not really a logical one, then I definitely agree 100 per cent with our brief that it should be completely separated from income.

The Chairman: What would you say to confining it in the beginning to securities and sales of businesses and mortgages?

Mr. Roman: I would like to think, again, that this particular tax, if it is established, is established on the basis that it is completely clearcut, that there is as little as possible open to some kind of question or misinterpretation and so on.

The Chairman: You mean, like valuations of paintings?

Mr. Roman: Yes.

The Chairman: And personal property.

Mr. Roman: I would say that "fast buck" as you call it, most of the time I think the fast buck turns out to be...

The Chairman: Pretty slow in delivery.

Mr. Roman: Yes, because if this Government would do one thing in this country, and put retroactive legislation to last year and establish the capital gains tax as of last year, I am sure that would be very negative the amount that they would be able to collect. In fact, they would have to turn some money back to the people who lost it in the last few months.

The Chairman: That is why it would be a mistake to let one write off capital losses against earned income.

Mr. MacDonald: I was going to say you agree with that, Mr. Roman.

Senator Laird: Could I introduce a new topic. I notice you are doing exploratory work in five foreign countries. I would be interested to know which five.

Mr. Roman: The United States, Ireland, Guyana, Jamaica, Ecuador—and Mexico, making six.

Senator Laird: What are your motives for doing that exploratory work? Could I suggest that they might be tax motives?

Mr. Roman: No. Our motives, senator, in looking for ore bodies or oil properties is that have an economic life. When they are more obvious in other parts of the world than in Canada, we have a certain budget that is for Canada and a certain budget directed to other parts of the world where we think discovery is possible. That is our motive.

Senator Laird: Would it not actually be somewhat easier for you financially and

managerially to confine your explanatory work to Canada?

Mr. Roman: Not necessarily. For instance, the work we are doing in Ecuador at the present time if of such an appeal that I do not think we can find one like that in Canada, in any place.

Senator Laird: What does interest me, is that you say you are not influenced by the tax climate in these places?

Mr. Roman: I did not say we are not influenced by the tax climate, but that is not our motivation, it is definitely not.

Mr. MacDonald: I think what Mr. Roman is trying to say is that it is not primarily the White Paper that has got him looking there, but obviously in terms of assessing what he can hope to make out of any of these particular ventures. He has to take into account the tax circumstances of each place.

Senator Phillips (Rigaud): Or, by the discovery of the oil, that perhaps it will lead to profit, and the determination of the income from the profit will depend on the tax climate.

Mr. Roman: That is quite so.

Senator Laird: Is the tax climate particularly good in these areas?

Mr. Roman: I think that in some areas it is much better than even in Canada today. In other areas it will be more favourable if the White Paper goes through, in these other countries.

Senator Laird: You are not doing any work in Australia?

Mr. Roman: No.

Senator Laird: I should mention that other companies who have been before us have picked on Australia and, quite frankly, they have said it was for tax reasons, that is one of the motives.

Mr. Roman: There again, I do not want to contradict any of the briefs that have come to the committee, but I cannot be myself unless I can express myself. Two or three years ago when certain companies went to certain parts of the world, I do not think that particular part of the world, including Australia, had a more favourable tax climate than we had for the present time. What they are worrying about at the present time is of course the White Paper. If the White Paper goes through, of course definitely Australia would be a lot more favourable for looking for ore bodies than Canada would be.

The Chairman: Are there any other points we have overlooked. We have had Mr. Roman's philosophy and we have had quite a discussion on tax holiday and depletion. Is there any other point?

Mr. MacDonald: On the capital gains issue, we would like to state that if there is going to be a capital gains tax, that it should be as little damaging as possible to the efficient operation of our capital markets—which is why we strongly recommended, not only a separate capital gains tax but also that people have the option of putting their capital assets into a pool and treating them as a pool, so that they would be free to make investment decisions and change their investments on the basis of economic merit, rather than because they would have to avoid a heavy transfer tax in order to change their investments.

The Chairman: That is the roll-over.

Mr. MacDonald: That is the roll-over. We would like to point out the difference under the White Paper and under the present American system. Under the American system, where a person creates a new enterprise, in the United States, and when it builds it to the point where he can only expand further by going public, under the American system he can, at that point, avoid a capital gains tax by entering into a share exchange arrangement with another company who would, in effect, take him over.

At that point, if he happens to choose the company wisely and well whose paper he takes and if he holds onto to that paper and never makes another move with it until he dies, then his heirs take the original shares of that original company, now represented by the shares in the take-over company, at their then value, and there is no capital gains tax at that time nor is there the potentiality of any capital gains tax to reflect the lifetime gain.

The two points to note about this are these. The first is, that this is infinitely more favourable to an entrepreneur in the United States who wants to start a company than the White Paper would be to an entrepreneur in Canada, because in Canada he would be taxed when he went public and of course he would be facing the five-year revaluation as well.

I think we can do better than the Americans, because this is a very inefficient way of doing things, to force people to take paper instead of money and to force them to hold on until they die before their assets become unlocked. We feel that the capital pool approach would resolve both of these problems.

Senator Phillips (Rigaud): Of course you were not here, Mr. MacDonald, this morning when we were dealing with the Toronto Stock Exchange. Leaving aside the question of share exchanges but relating it to estate taxes, we were facing this problem of the federal problem in the provinces, who, after all, claim right to estate taxes, and the difficulty resulting from what I call the simplicizing or co-ordination of the capital gains to the estate tax, which is one of the crucial points that has not been dealt with in the White Paper at all.

Mr. MacDonald: And, senator, you will no doubt have noted that this is a very real concern to the province of Ontario, who fear the introduction of the capital gains tax is unacceptable to important parts of the country.

Senator Phillips (Rigaud): I think you are right. I have taken the position, and I have repeated it on more than one occasion before the tax representative, that there must be an isolation of capital gains receipts and that they must be related to the transfers to provinces, after vacating the federal estate taxes. And depending upon the treatment of the estate taxes by the provinces, you move over the capital gains receipts to the provinces.

Unless you do that, you can have all the talk from here to Timuktu on the question of the necessity of relating capital gains taxes to estate taxes, and if you do not look squarely into the face of our constitutional problem as a federal system, you just cannot coordinate it.

The Chairman: Are there any other topics, Mr. MacDonald?

Mr. MacDonald: Mr. Chairman, I do not know whether your committee would wish to discuss the tax structure. I take it that you have it.

Senator Phillips (Rigaud): I think we have covered that pretty well, if I may say so.

The Chairman: That is right.

Mr. MacDonald: I think the only comment I would make is that one can envisage not only a move by the well-to-do out of the public into the private, but one can even imagine their moving out of private companies so that they can get direct access to the personal tax based.

For example, one can even imagine them carrying on foreign operations as an individual with a limited liability partnership so that they can get the benefit of the foreign tax credit directly in their own hands. There is another interesting twist, which is the reverse of this. That is, there are many Americans here who are taxed despite the fact that they live here on their U.S. incomes, an with a concept such as integration, if I may say so, the top 50 may actually effect the transfer of tax dollars to the United States Treasury which otherwise would have been collected in this country.

Senator Phillips (Rigaud): I think, Mr. Chairman, we have had that developed in prior briefs.

The Chairman: Yes. I always end, Mr. MacDonald and Mr. Roman, by saying that we seem to have exhausted the various points.

Senator Isnor: I have one point I would like to clear up with Mr. Roman. Mr. Roman, you said that Japan was a competitor. What is the main factor there?

Mr. Roman: I said that, putting everything into its proper perspective, we compete with, on one side, perhaps an eastern country and, on the other, with Japan. We have to have diffrent designs, diflerent approaches and different structures to be able to compete in productivity, and, as the end result, to be able to compete with Japan as against a country which is less developed and less efficient.

Senator Isnor: What is the main factor?

M. Roman: I do not quite understand your question.

Mr. MacDonald: Senator, if I may I think I know what you are asking. I do not think Mr. Roman meant that Japan was a direct competitor of his company. He was, rather, suggesting the relativity of competition in an attempt to answer a particular question.

The Chairman: When we get to the end of a hearing, Mr. Roman, I always say: is there any point we have missed? Is there an important feature which we have not developed as much as you would like? If there is, now is the time to say so.

Mr. MacDonald: No, I think not.

The Chairman: Well, thank you.

Mr. Roman: You have very capable people here to ask questions.

The Chairman: Honourable senators, the last submission we have today is from Loram Limited. We have Mr. Mannix, the President of Loram, who will make the opening statement and present his panel.

Mr. F. P. Mannix, President, Loram Limited: Thank you, Mr. Chairman. First of all, I should like to thank the honourable senators for granting our request to appear in defence of our brief. Secondly, I should also like to explain somewhat about Loram. Loram stands for "Long-range Mannix", which is a private company. I would like to introduce Mr. Connelly, on my right, who is Vice-President of Loram, and Mr. Lord, who is our tax counsel in our own company.

In terms of an opening statement, our brief is divided into two parts. The first part sets out what we consider to be the essential requirements for capital growth which is a prerequisite in providing a base for general prosperity and well-being so that Canada will be a place where people want to live, bring up their families and prosper.

The requirement for economic growth, we feel, is the maximization and the creation and the use of talent and the maximization and creation of capital. We, therefore, examined the White Paper in the context of these requirements.

The creation and maximization of talent is essential to economic growth. Canada's development in the past is largely attributable to the fact that resourceful and innovated individuals were willing to defer present enjoyment in favour of a gamble that a greater reward would be forthcoming several years in the future.

In order to motivate these individuals to take the risks involved, incentives were required. The prospect of being able to eventually realize a tax-free capital gain was one such incentive. The preferential low rate of tax on the first $35,000 of income, rapid write-offs on certain classes of assets, stock options and realistic averaging provisions are further examples.

The White Paper advocates the abolition of these incentives. Surely, therefore, it is clear that such abolition will have a disincentive effect if implemented. Canadians must anticipate a distinct slow-down in the country's growth.

To date we have not achieved the growth rate that the Economic Council of Canada feels is possible in this country.

When we speak of creation of capital, we speak of people deferring their personal enjoyment of income. These people must be motivated to make this sacrifice. The reinvestment of this income is essential to the country's economic growth. The White Paper advocates that a penalty should be imposed if corporate profits are not distributed to their shareholders within two and a half years, and the proposal goes further to tax capital gains and reduce the incentive to reinvest which, therefore, will further inhibit economic growth.

We have indicated in our brief that the redistribution of wealth is only effective if it causes poorer areas and unproductive areas to become productive. Otherwise, such redistribution must carry with it the following costs: the cost of supporting a multiplied effect if the money were spent in growth areas. We should, in other words, reinforce success.

We also have an opportunity cost because individuals, who are lying idle, should be productive and are to contribute instead of being non-productive.

We also have inflationary costs in the growth areas of the country because we pay higher prices for the lack of scarce resources which are lying idle elsewhere.

With respect to the specific proposals in the White Paper, we have commented on those which we consider to be potentially detrimental to the country's growth. We have recommended the following: no capital gains tax; the continuation and expansion of the dividend tax credit system; rejection of the integration proposals; continuation of the incentives for resource industries specifically; the retainment of the three-year new mining exemption; and that depletion allowances should not be restricted to one-third of exploration expenditures.

In addition, we have commented on the proposals in respect of entertainment expenses, depreciation and consolidated tax returns and income averaging.

It can be seen from the foregoing comments in our brief that we hope that many of the major proposals contained in the White Paper

will be rejected. If we were asked for an over-all comment as to what should be done with the White Paper, we would have to say, "Return it to the Government with thanks for the opportunity of being allowed to carry on a public debate," with the recommendation that it be scrapped and that the present act be maintained and amended from time to time as required, and thus removing the uncertainty that exists today.

Senator Phillips (Rigaud): In other words, you do not regard the White Paper as the Magna Carta of Canadian liberty.

Mr. Mannix: No, we do not.

The Chairman: Nor is it a definition of what a tax policy should be. I think you might tell us first, Mr. Mannix, because I have here a summary indicating the Mannix group of companies. Each senator has one as well. The make-up would appear to be in the category of a conglomerate, or is that a bad name?

Mr. Mannix: Well, it has bad connotations.

The Chairman: Let us take the bad connotations out of it, then.

Mr. Mannix: If you look at the last page you will see that it has been an orderly development from a construction base primarily, into related fields where we have tried to expand and where our strength lies.

The Chairman: I suppose basically, as I have known Mannix, it was in the construction field.

Mr. Mannix: That is right.

The Chairman: And the other elements have grown out of that. Is that correct?

Mr. Mannix: That is right, sir.

The Chairman: It is important to notice the quantity of your sales revenue of $85 million, your payroll and the number of employees. If, Mr. Mannix, you were asked to name your No. 1 problem presented by the White Paper, as far as you are concerned which one would you name?

Mr. Mannix: Well, the general philosophy, I believe, is that the No. 1 problem is that the incentives to encourage people to produce more than we already have are lacking in the proposals, almost without exception.

The Chairman: Lacking may not be the word, but rather that they are being taken away.

Mr. Mannix: Taken away and lacking.

The Chairman: Well, are there any comments you want to make on any particular application, such as, incentives to the mining industry and to the oil and gas industry? Have you any particular comments you want to add?

We are always looking for information as to whether there are any variations of the tax laws that you can suggest, or do you believe in the status quo?

Mr. Mannix: I think generally that the philosophy of the White Paper is to look at the oil and gas industry and the mining industries and say, "Ha, ha, here is somebody who is escaping taxation", and they have not really taken into consideration their ability to take risks and to compete in the international markets.

With regard to the proposals, the tax structure should contain proposals to encourage Canadians to take risks in their own country, and to take risks generally.

The tax holiday certainly promotes the ability to take risks, as does the depletion allowances, and I agree with Mr. Roman's comment that I would increase the incentives rather than decrease them on much the same grounds as he submitted, inasmuch as the tax structure perhaps should not be looking directly to the resource industries for tax revenues for the Government to spend, but rather, be providing a base for further development of the country. The Government should be looking at the secondary areas of revenues supplied by the secondary or support and multiplier-effects industries which are a result of the primary industries such as oil and mining.

The Chairman: Once you accept Government policy, as I think we must, judging by the legislation we have, that regional development is high on the priorities, then you are right into the mining industries and the gas and oil industry which have over the years been one of the greatest developers in that area of regional development, providing its own money without Government subsidy.

Mr. Mannix: That is correct.

The Chairman: So what you are saying is that arising out of what the industry does and the development that it makes, there is an enrichment to the economy of Canada in many directions, even though a direct payment by way of taxes from the mining com-

panies and the oil and gas companies may not, for a considerable time, loom very large.

Mr. Mannix: That is correct. It provides a base for additional follow-up in the development of the country, and a base, really for the Government to collect revenue from subsidiary industries, secondary industries and supporting industries that are created for these primary functions.

The Chairman: There must be great value—I do not know how you would assess it—in this Labrador development where you have a wilderness turned into a tremendous operation, producing not only income but producing substantial money for our balance of payments through the sale of their products outside of Canada, and providing jobs in secondary industries, and developing an area in Canada that otherwise just could not be developed if it could not lend itself to mining operations.

Mr. Mannix: That is correct. Certainly in the construction industry we follow as a secondary industry in the development. It is most alarming to us to see a slow-down in capital expenditures and in the general development of the country.

The Chairman: Would you tell us something about that? Where have you seen it and in what way? How does it manifest itself?

Mr. Mannix: The Syn-Crude operation, of which I am sure the gentlemen are aware,—for example, we are presently doing the mining for GCOS on the basis of stripping for GCOS and the tar sands. It is certainly on public record that Syn-Crude is in the position where they feel they cannot proceed under the proposals of the White Paper. And, of course, being really in the business of supplying services to these types of people, we see it directly affecting our business.

The Chairman: Has there been an actual slow-down, or are they dragging their feet, or have they abandoned the undertaking?

Mr. Mannix: Well, they are certainly dragging their feet; they want to see what is going to happen as far as the White Paper proposals are concerned.

I am sure you gentlemen have had many submissions before you that showed that people are dragging their feet in this area, and it is of concern to us also, in terms of being westerners, the lack of economic progress in the country.

Specifically in Quebec, if employment becomes worse and economic problems become worse there, it will be a worry to us, or at least it is to me, and perhaps it will feed separatism and the attendant problems.

We all know the length of time it takes before capital expenditures actually produce a multiplying effect on economic results, that is, in making the economy take off. I feel that if something is not done and if some policy decision is not made and if the uncertainty continues to exist, that the situation in Quebec, as well, can deteriorate because of this lag in economic development.

Senator Hays: How does the White Paper specifically concern your group of companies?

Mr. Mannix: Well, we are primarily concerned with the resource industries inasmuch as we are building dams, oil and gas pipelines, roads and site preparation for mines, et cetera, and stripping. The specific proposals of the White Paper affect us in respect of the dividends from the utilities which are fully taxable and it results in less work in the construction area. The removal of the three-year exemption from mines means fewer mines proceed and that the general development will be slower. The restriction of the depletion allowance basically affects the economics of the mines. Hence we also see that mines are not developed as quickly or as expeditiously as they could be and we lose the multiplier effect that the secondary industry would achieve through their immediate implementation.

The White Paper proposals, on the disappearance of depletion allowances on distribution to the shareholders, also mean that fewer people are willing to take the risk to develop projects. This again affects the construction and allied, related support industries.

Senator Benidickson: You are concentrating on the elimination of the shareholders' depletion rights, not the other depletion changes.

The Chairman: He mentioned that earlier.

Mr. Mannix: The depletion changes themselves adversely, changed the economics, and raised the question as to whether or not people would go ahead with the mine. Also, the disappearance of depletion allowance on distribution to the shareholders means there is less capital put up to finance and promote this sort of operation.

Senator Benidickson: I understand that. I take it that when you say "we" you are refer-

ring to Loram Limited, who is presenting this brief.

Mr. Mannix: That is correct, sir.

Senator Benidickson: Would you call that a holding company?

Mr. Mannix: Yes, sir. It is a management service company.

Senator Benidickson: Would you call it generally a holding company?

Mr. Mannix: As a by-product it is, inasmuch as we try to departmentalize our areas of risk and operations and also we provide the directorate for the boards on the companies that we own securities in.

Senator Benidickson: I do not know whether you were present this morning, but we had an interesting discussion about a possible way of taxing a holding company and services in a holding company. Which started first, the Mannix Construction Company or Loram Limited?

Mr. Mannix: The Mannix Construction Company was formed first. The name was changed to Loram and the construction operations spun out of it.

Senator Benidickson: With respect to Pembina Pipeline Limited, which is a public company, what percentage of ownership has Loram Limited in Pembina Pipeline Limited?

Mr. Mannix: Approximately 49 per cent.

Senator Benidickson: Is that voting shares or capital of all kinds?

Mr. Mannix: Voting shares, which is capital of all kinds other than some bonds.

Senator Benidickson: Loram Limited and its surplus would be required from time to time to make investments in other similar subsidiaries.

Mr. Mannix: That is correct, sir.

Senator Benidickson: It has done so after Mannix Company Limited created some capital?

Mr. Mannix: That is correct.

Senator Hays: Why would the White Paper specifically affect your companies? Do you know if it has affected them now or has there been any withdrawals on certain contracts? If so, can this be documented?

Mr. Mannix: Well, Syn-Crude is a perfect example of one which has certainly slowed up. It is very often, specifically with construction, that you are really not invited into a job until such time as the decisions have already been made to go ahead. The general climate and the feeling we get from a number of people asking us to look at proposals or projects which they have coming up in their books is such that they are standing by to watch and see what the results will be of the White Paper.

Senator Hays: Have there been any tenders let out that they have put time clauses and that sort of thing in in so far as the White Paper is concerned?

Mr. Mannix: None that I am aware of specifically.

The Chairman: How does the slow-down by Syn-Crude manifest itself?

Mr. Mannix: We have been negotiating with Syn-Crude because of our position with GCOS, where we have done the stripping. They have of course been interested in the expertise that we have gained there. We have put in a couple of proposals to them, basically as a result of the White Paper. The thinking has been that they have really stopped in their tracks to see what will be done. They have not proceeded at all as far as our own participation or looking at their operations.

The Chairman: Your proposals are sitting then?

Mr. Mannix: That is right.

Senator Phillips (Rigaud): Which has slowed down more, the construction industry generally or the extracting industries in your area?

Mr. Mannix: The construction industry. At the present time both the extractive industry we are involved in, such as the coal company and the pipe line company, due to the additional oil that the United States has been taking during the first part of the year until their quotas were established and also because of the increased use of coal, both the resources have gone really ahead in the last year.

Senator Phillips (Rigaud): Isolating Loram as a company and getting management income you are not affected by the terms of the White Paper. In terms of dividend income from Canadian companies which are exempt

under the present law your problem would arise in integration, would it not?

Mr. Mannix: Certainly they would arise in that manner, but Loram is especially set up for operational reasons and not in terms of being a financial company as an investment company.

Senator Phillips (Rigaud): You have your constituent operating companies and presumably the shares in those companies are owned mainly by Loram?

Mr. Mannix: That is correct.

The Chairman: I would assume dividends flow through?

Senator Phillips (Rigaud): As they flow through, if they were to flow out of Loram to the shareholders you would have your integration problems?

Mr. Mannix: That is crrect.

Senator Molson: They are a group of companies, a Mannix group, and the group is represented by Loram in this instance as being the management section?

Mr. Mannix: That is correct.

Senator Molson: Given a dimension, what would be the overall volume done by the Mannix group and what would be the number of employees on the payrolls?

The Chairman: That is in the statement.

Senator Molson: It is not here in total.

Mr. Mannix: The total sales are in the range of $85 million. In 1969 the payroll was $23.4 million and the average total monthly number of employees was about 2,400. That varies considerably with the projects that are undertaken in the construction arm, and can run as high as 7,000 or 8,000 or even more.

Senator Benidickson: Forgetting the holding company, if I can use that term, with respect to Loram, from what I see without totalling this it is still the company with the large payroll and the largest number of employees.

The Chairman: You mean Mannix?

Senator Benidickson: Mannix. You refer to subsidiary companies unlisted and then you refer to associated and affiliated companies. Are you using in your definitions what would be taken to mean those things in the Income Tax Act?

Mr. Mannix: Yes, in the associated affiliated companies the shares are not held by Loram. They are held by the Mannix family.

Senator Benidickson: You have perhaps what is effective control.

Mr. Mannix: That is correct.

The Chairman: By that you mean the associated and affiliated companies pay management fees, but the earnings would go through to the shareholders who would be members of the family?

Mr. Mannix: That is correct.

Senator Phillips (Rigaud): In your set-up would you favour a consolidated tax return?

Mr. W. R. Lord, Counsel, Loram Limited: Definitely.

Senator Phillips (Rigaud): You recommend it, do you not?

The Chairman: Yes, they do.

Mr. Lord: We recommended it because we feel the necessity of having separate corporations to operate separate businesses comes out of the multitude of different reasons. There may be reasons within the jurisdiction in which you are operating and there may be other situations. We have listed in our brief several different reasons, plus the fact that essentially one group of companies is operating.

Senator Phillips (Rigaud): I think you are a typically good instance, in my opinion, of the desirability of going back to a consolidated tax return because you clearly have different companies to deal with different departmentalized aspects of your business.

Mr. Lord: That is right. We suggest that the White Paper's way out of that is by way of using the partnership option, it not broad enough, that it is partly restrictive to us.

Senator Phillips (Rigaud): Have you any non-resident shareholders in your companies?

Mr. Mannix: No, except in the public sector of Pembroke.

Senator Phillips (Rigaud): Only?

Mr. Lord: We do have different classes of shares.

Senator Phillips (Rigaud): With respect to that, I suppose the objections we have heard with respect to integration are applicable, too?

The Chairman: I take it that, if you have not said so already, you do not support the White Paper integration?

Mr. Mannix: That goes without saying.

The Chairman: The record has to record the fact.

Mr. Mannix: We do not support it.

The Chairman: Then we do not need to go into the individual aspects, like the 2½-year limitation on creditable tax on surplus, nor on the five-year deemed revaluation. Those things are all wrapped up in your answer that you do not support integration?

Mr. Mannix: That is right.

Mr. E. Connelly, Vice-President, Loram Limited: Mr. Chairman, could I reply to Senator Hays? He asked the effect the White Paper has on certain organizations. There are two further aspects. I have been with the Mannix organization since we had nothing, but we grew to a fairly sizeable organization. At all times the Mannix family transferred that, they have taken very little out of these companies, they turned it all back to make this company into a viable Canadian organization.

When I went there first, we were controlled by an American organization, the largest in the world. After four or five years we succeeded in purchasing their interests. It took many years for them to pay off this obligation. This is a fine example of the type of capital problem, and the type of preferment and judgment that I think we should try to serve in this country.

We have two areas in this particular White Paper. One is the question of good will. The good will of the Mnnix organization has taken since 1898 to build up. You cannot say it is made, as the White Paper said, in a period of four or five years. This is long term good will. The good will is in a service industry and good will is based on the relations which the organization has with the people who do work for it.

I am very close to this situation and feel very strongly about this. The fact that at the end of the year, what happens would be that the good will built up over this time would be taxed at the rate of 40 per cent in the first year and decline to absolutely confiscation of capital. That is number one.

The second thing is that if it had not been for the Mannix industry I believe that the coal industry in western Canada would be out of existence today. They held us together. They were the first people who went to Japan and brought people over and who gave them their own money to get them interested in this particular business.

Also, at the same time, at our expense, we picked up large reserves of coal for the power facilities in western Canada, down south, for the use of coal and hydro.

This was all done by Mr. Mannix's father.

We have certain reserves which we have built up over the years. It is the purpose of the White Paper, just as soon as we have this as the capital of our company, to take these reserves and tax them immediately, if they were sold, at the basis of 60 per cent the first year, which is a capital asset, and this again would decline at the rate of five per cent a year.

The Chairman: I take it, then, you do not favour good will as provided by the proposal in the White Paper?

Mr. Connelly: No. The people have grown up with these companies—and I personally have been associated with a number of small companies who have grown in this way, just with the talents of people willing to defer their enjoyment. I feel that some senators who know me here know what I am talking about. To wait ten, twenty or thirty years and then tax either good will or assets that people have acquired, which are actually capital assets, is not only confiscation of capital, it is retroactive taxation, it not only creates uncertainty but will certainly create an atmosphere, amongst the people that I am used to doing business with, that they will certainly not continue to do that type of work any more.

Senator Hays: Do you carry the good will as a capital asset?

Mr. Connelly: We do not carry it, but it is inherent in the business, if you want to sell it, especially in the service industry.

The Chairman: Do you think good will should be treated the same as land?

Mr. Connelly: It should be a capital asset. If you want to consider purchase of a capital

assets, it would appreciate it according to those terms of 10 per cent. There is no reason why, if you put a value at valuation day, why the same treatment should not be given to them and it only be taken into income for the next residue value over that and what is realized on it at the time of sale.

I want to stress those two points because I think they are very important.

The other was the question of wasting asset, which was discussed as far as mining is concerned.

I do not look on depletion as depletion per se, because a wasting asset could eventually run out of your mine. We have done this in coal mines and we have done this in iron and other mines that we were in and have ended up with no asset. This is not like building up an ordinary organization which is based on population factor. The result is that, in order to get an incentive for people, they must motivate people to have an interest in the wasting asset. The rate of return must be materially higher, materially higher, just apart from the actual risk of the investment itself, which is one factor. The mere fact of dealing with a wasting asset instead of with a growth asset is that you have to have a material increase in the rate of return.

Senator Bendickson: You are talking about depletion and the . . . ?

Mr. Connelly: I look on depletion as merely an adjustment in the rate of tax.

Senator Hays: Am I right that in your brief you say you mine about 35 per cent of the coal in Canada. Is that correct?

Mr. Connelly: That is correct.

Senator Benidickson: How long would the White Paper affect this kind of operation as far as your coal is concerned?

Mr. Mannix: The elimination of the three-year exemption of course affects your competitive position in world markets vis-à-vis Australia, for example, where the Japanese are getting coal from Australia. The three-year exemption certainly enhances Canadian competitive position to ship coal from western Canada.

The restriction on the depletion allowance increases, in effect, the risk that you are running in assessing the mine, and your exploration has been required at the time you start the mine and the risks have been taken and the asset is then wasting, so your competitive position is affected vis-à-vis Australia, for example, in shipping coal, and I am sure that part of the reason that Kaiser is competitive in Japan is because of the tax climate we have here now.

Senator Hays: Are you saying, Mr. Mannix, that under the White Paper you could not compete with Australia if depletion was taken off?

Mr. Mannix: Well, certainly it would take much better property with much more considerable mining just to be able to compete.

Senator Hays: What is the volume of sales now for the coal in foreign markets, espcially in Japan, I suppose.

Mr. Mannix: Of course, it is really just getting off the ground. There are about 13 million tons in a year, and McIntyre Porcupine are going to ship 100 million tons a year. They will probably add another one-third within the next two years.

Of course, we should be able to look to a continuing growth rate being pretty substantial. I would not be surprised to see the western Canadian coal industry, in terms of shipment to Japan, et cetera, double within the next ten years.

Senator Hays: What is this in dollars?

Mr. Mannix: I really could not tell you the number of dollars it would be, but it would have a substantial foreign exchange.

Senator Hays: You are talking about 14 million tons at what price?

Mr. Mannix: Well, Kiser Coal f.o.b. Roberts Bank is in the range of $12 to $14, so you are talking around . . .

Mr. Connelly: That price under the new coal arrangements will be up around $17 or $18. The original order was $13 and $14. The new ones, because the Europeans have now entered the western Canadian coal market, are offering $20 f.o.b. Vancouver for this coal.

Mr. Mannix: The picture in the coal industry is changing very rapidly for several different reasons. The sulphur content of Canadian western coal is low and there has been a lot of talk about pollution. As a result, the demand for low sulphur coal is going up.

It is also generally recognized that there are shortages now of coal. Germany, France, Belgium and even Romania and Japan, of course, are all looking for coke and coal.

Senator Hays: These are all new markets for coke and coal?

Mr. Mannix: These are all new markets that have really just developed within the last year; many of them have developed within the last year.

Mr. Connelly: That works out to about $150 million a year, and these contracts are for 15 years.

The Chairman: This is over-all, not just Mannix production.

Mr. Connelly: No, this is over-all, and the bulk of the money is being put up by the purchasers for the development of these properties.

Senator Benidickson: Particularly in western Canada, the coal is forecast for Japan, I suppose.

Mr. Connelly: Now there is also Belgium, Italy and Germany.

Senator Benidickson: I do not claim, of course, Mr. Chairman, to know anything about this in depth, but I did read within the last few days that it was suggested that our Canadian steel producers have missed the boat in getting contracts for western Canadian coking coal. Now, that is not relevant to our discussion here, except that we are concerned about the White Paper in so far as it deals with depletion allowances.

Now, I see that you are in the coal business in that Alberta Coal Limited is an associated company and has a coal production of great substance. Have you an opportunity with respect to coal to earn, under the White Paper proposals, depletion allowances by going out for further development and discoveries, or have you more or less enough property and resources that are adequate for what you propose to do and, therefore, could not benefit under the White Paper proposals? I am speaking of earned depletion.

Mr. Mannix: Yes.

Mr. Connelly: Basically we never stop looking for coal, but we have enough reserves on hand under control without further exploration to take care of our needs for at least 20 or 30 years.

Senator Benidickson: We have had evidence from other types of mining operations to the effect that they have already done their exploration and development and have reserves adequate for the normal future, and that therefore the incentive idea of the White Paper for earning depletion is not very attractive.

Do you find yourself in that position?

Mr. Connelly: That is true, but we understand from the wording of the White Paper that we will no longer get the ten cents per ton depletion. The White Paper is quite quiet on that.

The Chairman: You mean the subsidy?

Mr. Lord: Unless we earn it.

The Chairman: Why?

Mr. Lord: May I point out here, senator, that it goes beyond that. Even if we did earn it, the whole company would be able to reduce its annual tax bill by way of depletion allowances still on redistribution to the shareholders. Eventually this whole depletion benefit disappears.

We have demonstrated this with regard to an oil and gas company on page 19 of our brief.

Senator Benidickson: I am not concerned about that. There is no suggestion in the White Paper that there will be a continuance of the shareholders' present depletion allowances.

Mr. Lord: No, I am not talking about that. I am talking about the fact that distribution, with the integration system, of creditable taxes is less than 50 per cent of the income and therefore when you gross it up and apply the credit the shareholder does not get a refund.

Senator Benidickson: Because it has to be credited to that and relate it to the corporation's tax-paying statement.

Mr. Lord: Right.

Senator Hays: Mr. Mannix, you operate in several countries. What in your opinion would be your position competition-wise with other countries if the White Paper were introduced as legislation?

Mr. Mannix: Certainly our competitive position would deteriorate. The construction industry is already very highly competitive and especially for Canadians because there are very large firms with which you have to compete on a continual basis not only at home but also abroad.

In effect by and large they are American companies, although you run into other ones and for example, the Italian Government supports directly by subsidy many other construction arms which basically means that it is almost impossible for a Canadan construction company to compete in areas of work in which they have decided to compete directly.

A good example of that is pipelining in Australia. The Australian pipelines have been built. The Italians have gone and done this work using Italian steel and basically government supported. The contractors have done work for approximately one-third of what a Canadian company could hope to even approach in terms of cost to the owner.

The construction industry is very volatile and it may be very marginal. You have very high risks and the aspect of the White Paper in terms of taxing capital gains certainly increases the rate of return that you would have to have in order to take risks.

The earnings by and large of many construction companies are ploughed back into equipment and back into the business for growth and the capital requirements for equipment are escalating at such a rate that the taxation of capital gains—if the firm were sold or even on an evaluation basis—is such that it really means that construction would be an extremely marginal business.

And because of the inflation aspect of the equipment that is used really, unless the capital gains tax took into account the real capital gain—by "real" I mean in terms of real dollars not just dollar dollars—in other words the inflation factor—although the Government can say they are going to do away with inflation and it will not be a factor—is constantly eroding the capital and as a result you need more and more capital to be able to operate and consequently a higher risk is taken. So if you are continuing to plough back earnings into the company to maintain the same level of expertise and basic tools in terms of equipment, in the result you are really looking at your capital appreciation as part of the earnings instead of just straight earnings.

To the extent that capital gains proposes to tax those it reduces the attractiveness of anyone entering the construction industry, the heavy construction industry specifically.

Senator Hays: Are you doing any construction work now in Australia?

Mr. Mannix: Well, we have recently completed a couple of jobs there. Just at the moment we have got nothing now.

Senator Hays: How are you treated taxwise in relationship between Australia and Canada?

Mr. Lord: The burden in Australia is slightly less. I think the top rate is $37\frac{1}{2}$ per cent and then there is a withholding tax of 15 per cent on distribution, so it comes in here about 45 per cent or 46 per cent, or something like that.

The Chairman: Do you have any other feature points that you would like to develop, Mr. Mannix?

Mr. Connelly: There is the question of Canada Pipe Line itself. The White Paper contemplates that all of the properties that we have purchased up to the date of the White Paper would cease to get depreciation allowances on the earnings from the date of the White Paper or phase it out at five years.

These feasibility studies are based on the life of the properties and certainly any attempt to tax on the basis of the White Paper would again be confiscating capital.

There is another thing I want to stress in relation to Calgary. Calgary, as you know, has had a tremendous growth after 1947 when the Leduc field came in and that brought a great many Americans into the country, highly talented people who actually brought their talents and know-how to us.

Now, they knew that the rate of tax in the United States was definitely lower on earnings than those in Canada. They had to be compensated in two ways. Either by an increase in salaries and so on which the major oil companies did, or else many of these men were retained by others or even organized their own companies. They were retained by other companies with which they had share options. If they started their own companies they knew that their present income would be lower.

Many of these people—I speak from personal knowledge—have since become Canadian citizens so they could take advantage of our lower capital gains taxation.

Senator Benidickson: Yes, and probably higher income tax.

Mr. Connelly: Higher current income tax.

Senator Benidickson: In the middle income bracket.

Mr. Connelly: And they had hopes of making substantial capital gains. Many of them have done this. Now, the net result, of course, is that Canada has permanently a source of talent and in fact in Calgary itself we have the highest concentration of professional people in Canada.

Consequently I think that any effort to impose any part of the capital gains tax, which will even equal or approach that of the Americans, would be detrimental to the growth of western Canada.

The Chairman: Meaning these people would move out.

Mr. Connelly: Yes. Not only would they move out, they would not have any inducement to live there through the major oil companies with their pension funds and so on that they have and they certainly would not have any inducement to start up there any organization in engineering or mining and so forth.

Now, there is another factor to this thing which is the reverse. I was told to use this gentleman's name and it is a name which is quite prominent in the pipeline business.

Mr. Bannister sold out last year to the Continental Computer Association of the United States. Mr. Bannister became chairman of the board. This company got into trouble and they asked him to be the president. This was a multinational company. He said he would do so if they would move their headquarters to Edmonton. On assessment the key people that he would have to bring from Pennsylvania, had to have in the neighbourhood of in excess of $10,000 a year—this is on present taxation much less the White Paper—to come to Canada.

This is just to equal their position in the United States, so this just proves that the figures that had been handed out by the Department of Finance here are somewhat misleading when they start comparing the present tax rates here and the United States.

Then what happened is the executive vice president—Mr. Bannister—decided he could make $7,000 more a year by moving to the United States so he moved their headquarters to Minneapolis. We have many examples of this.

The Chairman: That may only be the beginning of a headquarters exodus.

Mr. Connelly: Well, I am just pointing this out. This gentleman told me I could use his name.

Then there is another thing. We have a large number of senior executives in the major oil companies with a vast amount of knowledge of our country and so on who are retiring. I would just like to mention one here whom we all know, Paul Kartske of the Shell Oil Company. We would like these people to stay in this country. These people cannot afford to stay in this country and retire. I think this is a question of talent drain.

Senator Hays: Tell me more of why he cannot stay? Are you talking of the present taxation or the White Paper?

Mr. Connelly: It is the present rates. These people have been moving down under the present rates of taxes, but the rates of taxes under the White Paper are higher which will make it less attractive for these people to stay. The people here have an emotional problem. They have lived in Canada something like 20 years and they would like to stay in this country. They just think it creates a hardship and they cannot stay.

Senator Benidickson: Were you speaking about personal taxes?

Mr. Connelly: This is personal taxes.

Senator Benidickson: Or are you speaking about withholding taxes on pensions or both?

Mr. Connelly: Well, actually both in their cases but in some cases if it were a withholding tax, the pension is not involved. It is still more profitable for a person to retire in the United States than it is to stay in Canada.

Senator Benidickson: And I suppose in Calgary, from which you come, a lot of those people are, insofar as pensions are concerned, not paid through Canadian corporations. They are paid through American corporations and therefore this new proposed withholding tax with respect to pensions would not apply.

Mr. Connelly: That is true, that there are three things you have to consider. In the United States, you have a higher pay for the job. You have a lower rate of taxes in the United States and a lower basic cost of living. This is a fact. You have many other professions other than these to consider. The medical profession and others are considering this.

Now, there is one other problem here and that is the question, of which you spoke, of inflation.

The Chairman: Yes.

Mr. Connelly: There was one item. I wrote myself to Mr. Benson and I got back a letter with which naturally I did not agree. This is a sort of form letter but there is one deduction that is allowed today which I think is actually a hardship on this country and that is the $100 allowances for medical expenses and charitable donations, that automatic deduction. With Medicare it has really obviated the necessity for medical expense allowances and very few of those claiming the $100 allowance contributed to charitable causes. Although it would create some administrative work, it would make our citizens more socially conscious through giving them a greater incentive to participate in private giving. That is one reduction. If they wanted to reserve something in the White Paper that is one thing.

Senator Benidickson: Increase the revenue?

Mr. Connelly: Now, I have a question here. Do you feel that different parts of the economy in the country should be stimulated through income tax provisions or that special grants be made by the Government itself? I think you have covered that in previous hearings. We think that the market place should determine the incentives.

I read a brief you had from the Canadian Hardware Association. Everyone was concerned about turning businesses over to their families. I have been associated with two or three small concerns. What we are more concerned with is turning business over to our employees.

The Chairman: The problem, as we have seen it, is that the proprietor of the business has built into it his own retirement income, and therefore at some stage when he wants to retire he has to sell. What we have been talking about is that when he is selling, if there is a capital gain in the course of the sale it should go into a retirement savings plan without being subject to capital gains tax. That is the kind of point you were thinking of?

Mr. Connelly: I was thinking of going further than that and turning over the business to the employees themselves. These employees usually do not have any capital. The seller is usually confronted with the problem of going public or selling to someone who has cash. You usually get a fair deal. The average owner would rather turn it over to his employees and give them time to pay it off. There is nothing wrong with the amount of tax which is exigible against the surplus effective rate of $16\frac{2}{3}$ per cent. I believe that should be tied to the payments as they are made in order to enable the person—these companies usually do not have cash. They have all been turned back. Usually the selling price is pretty well tied into the amount of the surplus.

The Chairman: It can be sold on an instalment plan. If it is sold for $100,000 there can be instalment payments of so much per year for 10 or 20 years. The instalment he receives would be the part that would be taxable.

Mr. Connelly: But right now in order to set the company up so that you can distribute, so that the money can be paid out of the company, you have to go through the process of paying tax from the company itself through amalgamation or some other way, and then create a preferred stock and make a distribution that way. My thought is that instead of having to pay right away initially to the Government, the distribution should be made throughout the life of the contract.

I am going to Senator Cameron's new school in Graz. I am going to a lecture over there on official controls. In so doing I ran into what they are operating in Germany and it bears out what Mr. Mannix said. It certainly seems stupid for Canada as a small country to start leading the parade as far as tax changes are concerned. The Germans tax on the most conservative basis that you could find possible, including special reserves for replacement and replacement of inventory. Any time you move into this area it puts the Canadian position, if we are trying to operate as a well-developed and major country in the world, in a less competitive position.

The Chairman: Thank you, very much, Mr. Connelly.

The committee adjourned.

APPENDIX "A"

THE WHITE PAPER AND THE CANADIAN CAPITAL MARKET

A submission by
The Toronto Stock Exchange
on Proposals for Tax Reform

May 1970

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Des exemplaires de ce mémoire, en français, seront disponibles, sur demande, à la Bourse de Toronto, Canada.

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Chapter ONE — SUMMARY of PRINCIPAL CONCLUSIONS and RECOMMENDATIONS

In presenting this submission, it is the wish of the Toronto Stock Exchange to contribute usefully to the development of a tax system which effectively fosters an economy beneficial to all Canadians. We have limited our comments largely to those areas where we feel our experience in, and knowledge of, the Canadian capital market permits us to make a useful contribution. In particular, we have concentrated upon those proposals which we feel would influence in a significant manner the operation of the Canadian capital market.

Time constraints have not permitted us to explore all of those avenues of reforms which we should have liked to consider. We should be most pleased, however, to work with the Committee on any matters where it is felt our particular competence would permit us to make a useful contribution.

It is our view that a just tax system can be a potent force in directing and promoting the development of the economy and in enhancing the quality of life. We submit that Canada requires a tax system which positively encourages saving and the provision of venture capital for investment in developing enterprises, and which provides a climate stimulating to those persons who possess the skills, enterprise and enthusiasm necessary for the development and efficient use of our resources. Such a tax system would encourage an adequate flow of capital into the capital market, and would permit that market to allocate funds—largely on the basis of economic considerations—to their most productive uses.

Our detailed examination of the proposals contained in the White Paper persuades us that its authors have not chosen to provide Canada with such a tax system. Rather,

they seem to have been content merely to provide a tax system which "does not interfere seriously with economic growth and productivity" (Para. 1.10). We consider this essentially negative attitude towards economic growth to be particularly inappropriate for Canada at this stage of its economic development. Indeed, it would appear that several of the major proposals contained in the White Paper not only fail to promote and encourage growth, but would actually discourage it significantly, and this at the expense of precisely those whom the White Paper would hope to benefit.

The Toronto Stock Exchange has offered in this Submission some alternative recommendations which would permit the attainment of the goals set forth in the White Paper. Our principal conclusions and recommendations are summarized below and also, in more detail, in the synopses included in Chapters Three and Four, the main analytical chapters.

CHAPTER TWO

PERSPECTIVES FOR TAX REFORM

We find in the White Paper an undue emphasis upon considerations of short-term equity, while the longer-run equity implications of the proposals based upon these considerations have received insufficient attention

If our major social and economic objectives are to be realized, the demands upon our capital resources will be enormous. If these demands are to be satisfied, the Canadian capital market must operate as efficiently as possible. The promotion of this efficiency is, therefore, an objective of the utmost importance, and one which our tax reformers must keep in mind.

In mobilizing savings for productive use and allocating capital efficiently among competing uses, the capital market performs an extremely important economic function. If this function is to be discharged with the utmost effectiveness, it is imperative that the tax system be neutral as between competing uses of capital. In this respect the proposals of the White Paper are defective.

Although the efficiency of the Canadian capital market has increased markedly in recent years, it is still a market which lacks breadth and depth. Many of the problems associated with this thinness of the market would be intensified by several of the proposals of the White Paper.

An efficiently functioning capital market requires continuing capital inflows. It is most unfortunate, therefore, that the authors of the White Paper have proposed tax reforms which fall with extreme severity upon saving. This must be to the ultimate detriment of the growth performance of the Canadian economy.

CHAPTER THREE

THE TAXATION OF THE CORPORATION AND THE SHAREHOLDER

An important conclusion of this Chapter is that the proposed distinction between closely-held companies (CHC's) and widely-held companies (WHC's) contributes a most unsatisfactory basis for tax reform, and would result in discriminatory and anomalous taxation.

The differing degrees of integration of corporate and personal income taxes proposed for the shareholders in the two types of corporations

and the differing methods proposed for the taxation of capital gains arising from their shares would result in severe tax discrimination against WHC's, and would deter CHC's from going public. Such results would adversely affect the supply of equity instruments available to Canadians, and so the growth of the Canadian economy.

The integration proposals would create a bias against Canadians investing in young dynamic companies, and would have the effect of increasing the relative attractiveness of these companies to non-residents.

The integration proposals would, if implemented, be a source of many serious administrative problems.

We recommend that the proposed distinction between CHC's and WHC's be abandoned. This would require the same degree of integration of corporate and personal income taxes for all corporations. We would suggest that this be accomplished by means of a modified dividend-received credit, possibly one with the rate of credit ranging from 25% in the case of low-income shareholders to 15% in the case of high-income shareholders. This method of integration would be less costly, in terms of revenue lost to the government, than that proposed in the White Paper. We recommend that the resulting saving be used to permit a system of capital gains taxation which is both less burdensome and more appropriate for the Canadian economy at this time than are the capital gains tax proposals advanced in the White Paper.

With the removal of the distinction between CHC's and WHC's, capital gains arising from the shares of both types of companies would be treated identically.

The facilities of the capital market are not as readily available to small corporations as they are to larger ones. This is particularly true for private companies. The tax system should be used to redress this non-neutrality. We recommend that small corporations continue to have the benefit of the low first-bracket rate which they at present enjoy.

CHAPTER FOUR

THE TAXATION OF CAPITAL GAINS

We accept the argument in the White Paper that inequity results where a capital gains tax is totally omitted from the tax system. The remedy to this inequity must be sought in a capital gains tax which is appropriate for Canada at this time. Such a tax would be one that (1) does not interfere unduly with the mobility of capital; (2) does not discourage Canadians from saving and investing current income or liquid balances; (3) does not create a bias against Canadians investing in Canada; and (4) acts as a deterrent to those who would liquidate their investments for consumption rather than re-investment. The method proposed in the White Paper for taxing capital gains scores badly in terms of the first three of these criteria; we therefore hold it to be a particularly inappropriate method for a young, capital-scarce country which has only begun to realize its economic potential.

The proposed treatment of gains arising from the shares of WHC's discriminates severely against such corporations, and is part of the deterrent generated in the White Paper against

companies going public and thereby gaining access to substantial pools of capital. The proposed full inclusion in taxable income of gains from the shares of CHC's is not a satisfactory offset to this discrimination. In addition there would appear to be situations in which this requirement may be easily avoided.

The White Paper recognizes that the proposed realization approach on capital gains generates locking-in effects. The only offset provided is the proposed quinquennial revaluations of the shares of WHC's. In general, the revaluations proposed in the White Paper are vulnerable to many criticisms. In particular such revaluations discriminate in several respects against Canadian investors and would lead to an increase in the number of Canadian firms taken over by non-residents. These considerations lead us to recommend against the implementation of the quinquennial revaluations.

It is recommended that Canada tax all capital gains in a uniform manner, one-third of such gains or losses being taken into taxable income in the year of their realization.

It is also recommended that the capital gains tax should provide for the optional use of a roll-over concept under which the capital gains tax would be deferred as long as the proceeds of liquidation are reinvested in eligible assets within a specified period of time. We further recommend that every incentive should be provided for small investors to embark upon a plan of savings in a roll-over program.

To minimize possible locking-in effects and discrimination as between different types of assets generating capital gains, we recommend that there be a deemed realization of all accrued but untaxed capital gains at the time of the death of the asset holder. We further recommend that the fraction of gains taken into taxable income upon a deemed realization be one-half of that normally taken into income.

We consider it imperative that the burdens of capital gains tax and estate taxes be considered conjointly. Canadian estate taxes are already appreciably more burdensome than those of the United States. To simply add a capital gains tax to the existing unadjusted estate tax system would be to penalize Canadian capital unconscionably, and this to the detriment of the future growth of the Canadian economy and the future standard of living of all Canadians.

We recommend that in proportion to increased reliance on capital gains taxation, there should be decreased reliance upon death duties.

The combination of a capital gains tax and the higher existing personal tax rates would be excessive in the transitional period. Accordingly the higher existing personal rates should be reduced coincident with the imposition of the capital gains tax.

Valuation Day values be optionally the higher of cost or Valuation Day prices, in effect extending to other securities the treatment already proposed for bonds.

Suitable amendments be made to the White Paper proposals that all persons leaving Canada be required to pay a tax on any unrealized gain in order to avoid difficulties the proposals create for those persons leaving the country temporarily or for health reasons and for temporary residents of Canada.

CHAPTER FIVE

GENERAL COMMENTARY

The reform proposals under consideration at the present time will not determine once and for all the most appropriate tax structure for Canada. As the Canadian economy matures, further reforms will undoubtedly be required. When these prove necessary, we would recommend that the White Paper technique once more be utilized.

The capacity of the economy to adjust rapidly to new circumstances, including a reformed tax system, is limited. This suggests that tax reforms should avoid sharp redirections of economic activity within short time spans. To avoid these, we recommend that any significant reforms be implemented in stages so as to permit the economy to adjust to one major change before it is confronted with another.

It is unfortunate that the authors of the White Paper have chosen to mix considerations of tax reform with those of yield. The assessment of the economic effects of the reform proposals is an extremely difficult undertaking; one must regret that it has been complicated by the need to assess the likely consequences of simultaneous and substantial increases in yield.

A policy of substituting public for private savings and investment would appear to be implicit in the White Paper. It is our view that the implementation of such a policy would be singularly inappropriate in the absence of a public mandate to do so.

The Toronto Stock Exchange believes that a vigorous expansion of the Canadian economy is a prerequisite for the achievement of virtually all other economic and social goals. The attainment of a more equal distribution of income would be a hollow victory if the income which is divided is far smaller than it could have been. We would hope that sight would not be lost of this fact when legislation incorporating the reform structure is drafted.

Chapter TWO

PERSPECTIVES FOR TAX REFORM

INTRODUCTION

The prime purpose of a tax system is to allocate in an equitable manner the burden of transferring resources from the private to the public sector of the economy. Equity considerations are therefore inevitably present in any formulation or reformulation of a tax structure. As the relative size of the public sector increased historically, it became widely appreciated that the tax system could also be used as a potent factor in influencing the level of economic activity, its efficiency, and its rate of growth. In consequence, it is now customary to appraise tax systems in terms of their equity, stabilization, growth, and efficiency implications.

The ease with which the relevant criteria may be identified in no way implies that the process of evaluation is a simple one. In the first place, while equity, growth, stability, and efficiency are all desired, their simultaneous pursuit may result in conflicts. For example, the highly progressive tax rates which some associate with equity may make impossible the achievement of a rate of growth sufficiently rapid to provide full employment and a satisfactory quality of life for an expanding labour force—that is, an overly aggressive pursuit of equity in the short-run, may well result in the inequity of unemployment in the longer-run.

Secondly, there is no absolute and immutable ranking of the criteria which is always appropriate for adjusting the tax system. In consequence, while a tax system must, in a democratic setting, be equitable to be viable, there is no presumption that in restructuring an already viable system equity considerations—particularly of the shorter-run variety—must take precedence over considerations of

growth, stability, and efficiency. Rather, the ordering of these will depend on the economic environment in which the restructuring is occurring, and will change with the changing relative importance of different economic problems. There should be no presumption, therefore, that the present attempts at restructuring the Canadian tax system will result in the "best possible" tax system for Canada. Rather, the objective has to be the much more modest one of achieving the structure which is most appropriate for Canada at this stage of its economic development. It is in this context that the proposals advanced in the White Paper should be considered.

Process of Reform The actual process of tax reform may be thought of as falling into several distinct stages involving the formulation of the broad objectives of the tax system, the specific goals of reform, and the actual proposals in which the reforms are couched. In the first of these, it is necessary to determine and state the broad objectives which the tax system is intended to serve. The actual reforms, however, must be guided by directives more specific than the broad goals or objectives. The second phase of reform therefore involves the translation of the broad goals into rather specific guidelines relating to such things as reasonable price stability, improved and more readily available housing, and an adequate inflow of capital for development purposes, to name but a few.

The final phase of reform sets forth the specific proposals which are directed at the achievement of the narrowly defined objectives. In arriving at these reforms, it is essential that the reformers recognize the constraints imposed by the existing economic structure and the existing tax system. The economy has considerable capacity to adjust to new circumstances—including a reformed tax system—if sufficient time is permitted for the adjustment process to operate. It must be recognized, however, that existing economic institutions and arrangements possess a substantial inertia; if excessive stresses and strains are to be avoided, this inertia must be recognized when the tax environment is being altered. In the context of tax reform, this suggests that changes which would significantly redirect economic activity be implemented both cautiously and over a realistic time span.

The need for caution is particularly great where the reform proposals would embark a country upon a course of taxation which is substantially uncharted in the experience of other countries. One cannot avoid apprehensions about such a course when the likely consequences are derived largely from speculation and rather uncertain projections.

Under these circumstances, it would appear that the least hazardous method of implementing reforms is one which involves phasing in the various reforms by stages. In this way, the adverse effects of rapid and substantial adjustments could be avoided, and a substantial measure of flexibility retained.

Broad Objectives The White Paper sets forth quite clearly the broad objectives which the Canadian tax system ought to serve (Para. 1.6). Paraphrased, these are:

1. *Equity*
2. ***Steady economic growth***
3. ***Continuing prosperity***
4. ***Recognition of modern social needs***
5. ***Ease of enforcement***
6. ***A system workable for the Provinces as well as the central government.***

We concur with this list of broad objectives. We do feel, however, that they should be supplemented by a list of the more specific objectives or priorities which tax reform

should accomplish. The priorities to be attached to the items included in such a list would probably vary from one person to another. We submit that whatever the priorities, a list which would meet with the approval of a very large number of Canadians would include the following items:

1. ***Greater control of Canadian industry by Canadians***
2. ***A reduction in regional disparities***
3. ***Improved housing***
4. ***Higher levels of employment***
5. ***Higher productivity***
6. ***Relative price stability***

The achievement of each of these specific objectives will be substantially influenced by the effectiveness of the Canadian capital market. By assessing the likely impact of the White Paper proposals upon the capital market, the Toronto Stock Exchange thereby hopes to contribute constructively to the process of improving the Canadian tax system.

EQUITY CONSIDERATIONS

An equitable distribution of the total tax burden is the first goal enunciated in the White Paper, and the equity theme is returned to, again and again, throughout Proposals for Tax Reform. In addition, much of the public debate on the White Paper has concentrated on the equity issue. It is essential, therefore, that we address ourselves to the concept of equity advanced in the White Paper.

The discussion of the broad principles of equity is relatively straightforward. Few would disagree with the principle that similarly circumstanced persons should pay similar taxes, while those in dissimilar circumstances should pay appropriately different taxes. The major difficulty, of course, arises in trying to determine the differences in tax liabilities which are appropriate for differently circumstanced individuals. In this area, there can be no totally objective rules, and adherence to different value judgments will lead to the advocacy of significantly different tax liabilities. The reconciliation of such differences is less a matter for economists than it is for politicians, for the latter alone are charged with the responsibility of determining what the public consensus is and seeing that it is properly reflected in legislation. While accepting this principle, there are nonetheless some observations relating to equity which we should like to make.

The Toronto Stock Exchange does not quarrel with the principle that, as between those persons with greater and lesser ability to pay taxes, the former should be called upon to bear a larger share of the burden of financing the public sector of the economy than the latter. The important issue is really that of how much more they should be called upon to pay, and in what manner the payment shall be made.

Where public expenditures are financed by means of a progressive tax system, income will be redistributed and the disparity of income distribution reduced. It is all too easy to conclude that the resulting more equal distribution of income is an equitable one, but we would suggest that considerable caution must be exercised in arriving at such a conclusion. In addition to influencing the distribution of income, the tax system can strongly influence the willingness and capacity of Canadians to save and invest and engage in productive activity. Should the incentives and motives underlying these activities be seriously impaired, then our economic performance will be adversely affected. It is thus entirely possible that an overly aggressive pursuit of what might be termed "short-term equity" may result, in the longer run, in fewer jobs and lower standards of living for the short-term benefici-

aries. It is, to say the least, a rather dubious usage to describe this as improving the equity of the tax system. We are convinced that the implementation of several of the White Paper proposals would result in precisely this type of "improvement" in equity.

Despite these cautionary observations, The Toronto Stock Exchange agrees that some of the White Paper proposals would result in a tax system more equitable than the present one. For example, the Exchange does not quarrel with the White Paper when it argues that the complete absence of a capital gains tax from the Canadian tax system is unfair. We are concerned, however, that in attempting to remedy this defect, the authors of the White Paper have been influenced by an excessive concern for what we have called short-term equity while neglecting the more important concept of long-term equity.

THE ROLE AND IMPORTANCE OF THE CAPITAL MARKET

There are several distinct levels of concern which the Members of The Toronto Stock Exchange may manifest towards Proposals for Tax Reform. They may be concerned, for example, as individuals whose tax liabilities will undoubtedly be influenced by the tax changes which are ultimately implemented. Also, they may be concerned as members of firms whose profitability may be affected by tax reform. Finally, their concern may be that of persons who are involved daily in the facilitation and promotion of growth in the Canadian economy and who are aware of the vital role which the capital market plays in this process. This Submission of The Toronto Stock Exchange derives from the third of these concerns, and reflects our anxiety that the achievement of the economic potential of Canada not be unnecessarily sacrificed by the pursuit of policies which emerge as inappropriate when considered in a longer-run context.

Need for an Efficient Capital Market The Toronto Stock Exchange is very much aware of the forces which operate in the capital market and of the manner in which these forces influence economic development. If our major social and economic objectives are to be realized, the demands upon our capital resources will be enormous. If these demands are to be satisfied, the Canadian capital market must operate with the greatest possible efficiency. The promotion of this efficiency is, therefore, an objective of the utmost importance, and one which our tax reformers must keep in mind at all times.

Concern with the operation of the capital market is not new. Realizing the importance of the contribution which an efficient capital market can make to the Canadian economy, both the Federal and Provincial Governments have commissioned several studies to examine various aspects of the operation of this market. These have included, for example, the Royal Commission on Banking and Finance, the Attorney General's Committee on Securities Legislation in Ontario, the Canadian Committee on Mutual Funds and Investment Contracts, the Report of the Committee to Examine Financial Institutions in Quebec and the Ontario Securities Commission's Studies on Financing of the Mining Industry and on Business Combinations and Private Placements. Despite the role which these studies have played in increasing the public awareness of the importance of the capital market, we feel that it may be useful to indicate summarily some of the functions and problems of the Canadian capital market.

Prime Function of the Capital Market The prime function of the capital market is to mobilize savings for productive use. If this process is done efficiently, the total savings of Canadians, together with any capital inflow from non-residents, will be used to the best advantage of the Canadian economy. Money savings will be converted into goods and services and jobs will be cre-

ated. By mobilizing savings in this manner, the capital market is productive in a socially beneficial way. The larger the pool of capital which is mobilized, the greater are the private and public benefits generated, and the greater is our national capacity to realize our social and economic objectives.

Ideally, the process of mobilizing capital and allocating it between competing uses should be dictated by economic considerations. This is not to imply that other factors—such as national, regional or social considerations—cannot validly be brought to bear in the market place. It must be realized, however, that the introduction of these other considerations will generate costs in terms of an economically less efficient allocation of capital. In the present context of tax reform, this suggests that interferences in the allocative functions of the capital market be limited to those situations where the social, regional and national gains clearly outweigh the costs of decreased economic efficiency.

Liquidity of the Canadian Capital Market Although the efficiency of the Canadian capital market has increased markedly in recent years, it is still a market which, for several reasons, lacks depth and breadth. By lack of depth is meant that many securities cannot be bought or sold promptly without inducing relatively large changes in price, and by lack of breadth is meant that there is an insufficiency of securities which can meet this test. Several factors contribute to this lack of breadth and depth—or, more generally, liquidity—of the Canadian equity market, such as:

- a large percentage of our listed securities are held in control blocks which leave a relatively limited supply available to the general public; (See Appendix "A" page 49)
- a very large number of our major companies are private companies, the shares of which are not generally available to the public; (See Appendix "B" page 51)
- the limited availability of suitable investment instruments tends to cause our investment intermediaries to concentrate on a relatively small number of securities; and (See Appendix "C" page 53).
- many of our companies have not as yet matured to the point where their securities can justifiably be distributed to the public.

These are largely problems which the passage of time and the process of maturation of the economy will tend to rectify. They assume particular importance, however, in the context of tax-reform proposals which would significantly alter the allocation of capital: re-allocations which could be contemplated with equanimity in a fully mature capital market may indeed be very disruptive in a market which tends to lack liquidity.

There is, however, a problem which threatens to become more serious with the passage of time. This stems from the size and rate of growth of investment intermediaries. The larger these become, both absolutely and in relation to the rest of the market, the more difficult it is to accommodate their transactions. If the Canadian capital market does not expand with sufficient rapidity, the intermediaries are likely to be forced to channel increasing flows of capital to those markets outside Canada which are sufficiently developed to provide the breadth and depth they require. This is a constraint which should be recognized in determining the reform proposals which should be implemented. The Toronto Stock Exchange is concerned that several of the proposals contained in the White Paper are likely to be seriously disruptive to the Canadian capital market.

SAVINGS

An efficiently functioning capital market requires sub-

stantial net inflows of new capital. In Canada, the sources of this capital are found in the savings of Canadian residents and businesses, and in the net inflows of capital from abroad. Considering the White Paper proposals from the point of view of their impact upon the capital market, it is necessary to express our alarm concerning the manner in which the proposed tax changes impinge with particular severity upon those income streams which are the most important sources of saving.

HUMAN MOTIVATION

In addition to the need for capital to meet the requirements of economic growth, it is necessary to have people with the required human skills and enterprise to lead Canada in the development and utilization of its resources. Once more, the proposals contained in the White Paper would appear to be fundamentally negative in their attitude towards Canada's requirement to retain and attract persons with the necessary entrepreneurial skills.

CANADIANIZATION OF THE ECONOMY

The Toronto Stock Exchange is in favour of the Canadianization of the Canadian economy wherever practicable. We approve of the White Paper's implicit aim of encouraging this process of Canadianization. It would appear, however, that several of the specific proposals contained in the White Paper are unlikely to further this process; indeed, there are several which would positively discourage it.

WIDER PUBLIC OWNERSHIP OF CANADIAN INDUSTRY

The last few years have seen a substantial number of smaller Canadian companies become public by offering a percentage of their ownership to Canadian investors. This must be considered beneficial to the Canadian economy: on the one hand, the ability of a company to gain access to broader sources of equity capital permits it to establish a firm basis for future growth; while on the other, these companies have, in going public, provided new investment opportunities in Canada for Canadians.

It is clear that the White Paper recognizes the importance of this process, but several of its proposals would create artificial barriers which would deter companies from in fact going public. The differing degree of integration of corporate and personal income taxes proposed for closely-held and widely-held corporations, and the different proposed methods of taxing capital gains arising from the ownership of their shares, would have this effect.

PRODUCTIVITY

Canadians have noted with concern the comments of the Economic Council of Canada on the relatively poor performance of Canada in raising productivity, and the great emphasis that the Council places upon improving our performance in this area. We must express our concern over the fact that the authors of the White Paper have apparently made no effort to use the tax system to help solve this particular problem. Indeed, by reducing the supply of private savings and by encouraging firms to remain private, the White Paper proposals are likely to affect adversely investment and the scale of productive units, thereby complicating the already formidable task of raising productivity in Canada at a more rapid rate. We submit that a tax system which does not attack this problem is not an appropriate one for Canada at this time.

CONCLUSION

In the following chapters The Toronto Stock Exchange has endeavoured to assess the proposals of the White Paper within the framework of the concerns expressed in this Chapter. In many cases, we have concluded that these proposals would hinder rather than promote the attainment of the goals set forth in the White Paper. We offer alternative solutions which we suggest, are more appropriate for Canada at this time.

Chapter THREE

THE TAXATION OF THE CORPORATION AND THE SHAREHOLDER

SYNOPSIS

This chapter is concerned with the differential treatment proposed in the White Paper for the taxation of closely-held corporations (CHC's) and widely-held corporations (WHC's). It is argued that the several proposals which are founded upon this distinction should be treated as a package, one which stands or falls with the viability of that distinction. In addition to the distinction itself, the other principal constituents of this package are the differing degrees of integration of corporate and personal income taxes to be accorded shareholders in the two types of corporations, and the differing methods proposed for the taxation of capital gains arising from their shares. Sections of the chapter are devoted to detailed analyses of each of these principal components.

The main submission of this chapter is that the proposed distinction between CHC's and WHC's constitutes a most unsatisfactory basis for tax reform, and that its implementation would yield discriminatory and anomalous results. In particular, it is argued that the implementation of the entire package would result in a tax system which would discriminate severely against WHC's, and deter CHC's from going public. It is argued that these results would adversely affect the growth of the Canadian economy, and the supply of equity instruments to the capital market. It is also concluded that the integration proposals would create a bias against Canadians investing in young, dynamic companies, a bias which would tend to cause these companies to become more attractive to non-residents. In addition, the integration proposals would be a source of serious administrative problems. The main recommendations in this chapter are as follows:

1. *We recommend against the implementation of the proposed distinction between CHC's and WHC's.*

2. *We also recommend that, as far as possible, all corporate profits be taxed alike. This would require the same degree of integration of corporate and personal income taxes for all corporations, and we suggest that this be accomplished by means of a modified dividend-received credit, possibly one with the rate of credit ranging from 25% in the case of low-income stockholders, to 15% in the case of high-income stockholders. This would be appreciably less costly than the integration proposals advanced in the White Paper, and the resulting saving should be used to permit the implementation of a more appropriate capital gains tax.*

3. *We further recommend that all capital gains arising from the ownership of corporate shares be treated in a uniform and neutral manner, regardless of whether or not the corporation is widely or closely-held.*

4. *We acknowledge that the facilities of the capital market are not as readily available to small corporations as they are to larger ones. This is particularly true for private companies. The tax system should be used to redress this non-neutrality. The existing system does this and permits small companies to generate capital internally. We recommend that small corporations continue to have the benefit of the low first-bracket rate which they at present enjoy.*

PROPOSED DISTINCTION BETWEEN CLOSELY-HELD AND WIDELY-HELD CORPORATIONS

From the viewpoint of the capital market, one of the most important proposals advanced in the White Paper suggests that, for tax purposes, two classes of corporations be distinguished: namely, closely-held corporations and widely-held corporations. This distinction occupies a crucial position in the White Paper, for it is suggested that it be used to provide for differing degrees of integration of corporate and personal income taxes for the two types of corporations, and also for different approaches to the taxation of capital gains arising from the ownership of their shares.

Reasons for CHC—WHC Distinction Three considerations are advanced in the White Paper to justify the distinction. These are:

1. ***The different nature of the relationship between the shareholder and the corporation***
2. ***The different competitive environments in which the two types of corporations tend to operate***
3. ***The differing marketability of their shares.***

Corporations do indeed differ with respect to these three characteristics. It is necessary to question, however, whether these differences are so systematically related as to constitute a satisfactory basis for the imposition of significantly differing tax systems. It is our view that they are not.

Difficulties with the Distinction The White Paper states that, in effect, small corporations tend to compete with other small corporations, partnerships or proprietorships; that their shareholders tend to be involved in their management; and that their shares are not readily marketable. On the other hand, it suggests that large corporations tend to compete with other large corporations; that their shareholders are not involved in their management in a significant manner; and that their shares are readily marketable.

As statements of tendency these categorizations of small and large corporations may be relatively satisfactory. In practice, however, the exceptions to them are so numerous and so significant that they should not be used in reshaping the tax structure.

The connection between the involvement of shareholders in management and the competitive environment in which the corporation operates, on the one hand, and the fact of the corporation being listed on a Canadian exchange, on the other, is most tenuous. Examples can be readily found of corporations, which while listed are nonetheless managed by their principal shareholders (See Appendix "A" page 49). In addition, there are many companies which have one class of security listed on a Canadian Exchange, while participation in management is restricted to those holding another class of security which is unlisted (See Appendix "D" page 54). It is also easy to identify a large number of listed corporations, which find their major competitors in what would be, under the White Paper proposals, the class of CHC's (See Appendix "E" page 55). Finally, the fact of listing does not necessarily imply that the securities of a corporation are highly marketable. There are many examples of listed companies whose shares are seldom traded and highly illiquid (See Appendix "F" page 56). This last point is argued in greater detail in the discussion relating to the proposals for integration of personal and corporate income taxes.

The use of the proposed categories would, in conjunction with the other proposals of the White Paper, result in significantly different taxation of companies such as Swifts and Canada Packers, the Canadian subsidiaries of General Motors and Ford, and Eaton's and Simpson's. We

submit that it is indefensible to tax differently such close and obvious competitors.

We have considered whether any other basis could be used to distinguish between corporations. We have not been able to ascertain any alternatives which would be satisfactory.

These several considerations prompt us to conclude that the proposed distinction between CHC's and WHC's does not constitute a satisfactory foundation for the imposition of significantly different tax systems. In many instances, it would where no substantive differences exist, create tax differences which would significantly affect the allocation of capital by the market mechanism, and the competitive positions of the firms involved. We therefore recommend strongly against the implementation of the proposed distinction between CHC's and WHC's. As a general proposition we think all corporate income should be taxed alike.

Small Corporations We recognize that a uniform tax approach will occasion certain difficulties for small corporations. We acknowledge that small corporations are more sensitive to taxation than are larger corporations. Nor are the facilities of the capital market as readily available to small corporations as they are to larger ones. This is particularly true for private companies. The tax system should be used to redress this non-neutrality. The present system does this and permits small corporations to generate capital internally.

We recommend that the existing differential between the first and second bracket corporate rates be continued for "small" corporations which might be defined as corporations with assets of less than $1,000,000 or gross revenues less than $10,000,000. These are, of course, the definitional criteria set forth in the Report of the Royal Commission on Taxation and we can see little reason for quarrelling with them.

This recommendation would eliminate the criticisms of the existing system which permits all corporations, regardless of size, to benefit from the lower first-bracket rate.

If this recommendation is not accepted, as an alternative

We recommend that a lower rate of taxation be available for the first, say, eight years of the existence of a "small" corporation to facilitate its expansion during the period in which it is endeavouring to become firmly established and when the above difficulties are particularly significant.

It would be essential, however, that this privilege be safeguarded against the abuse of repeated use. We are confident that satisfactory safeguards may be readily devised.

One of the basic propositions of the White Paper proposals is that their implementation would result in a tax system which was neutral as between proprietorships, partnerships, and small corporations. This is a highly desirable proposal, and one which should be achieved if at all possible. Perhaps one way of safeguarding this neutrality, within the general framework of treating all corporations alike, would be to permit "small" corporations the option of being taxed as partnerships. Such an option would preserve the advantages of limited liability, without at the same time imposing any tax disadvantages, as a consequence of incorporation.

We therefore recommend that the partnership option be available to "small" corporations.

PROPOSED INTEGRATION OF CORPORATE AND PERSONAL INCOME TAXES

The present Canadian tax system subjects corporate source income to a corporate income tax levied at the corporate level when income is earned, and to a personal income tax upon its distribution to shareholders. The existence of double taxation of this income has long been recognized, and the dividend-received credit which was introduced in 1949 was viewed as a partial offset to this. As the White Paper makes clear, this particular relief device suffers from the defect of granting proportionately more relief to high-income than to low-income shareholders. In addition, it in no way provides for a rebate to those shareholders whose tax liabilities are exceeded by their claimable credits. The White Paper also expresses concern over those instances where the dividend-received credit is granted even though the dividend-paying corporation has not paid full and current corporate income taxes.

Given these deficiencies of the dividend-received credit, it is hardly surprising that the White Paper proposes to adopt some alternative method of providing relief from the double taxation of dividend income. The method which has been proposed is similar to the so-called "withholding" approach to the taxation of corporate source income, which was relatively recently abandoned in the United Kingdom. In essence, this involves the shareholder taking into his taxable income both the dividend which he receives from the corporation and the amount of corporate tax paid upon it, and then claiming as a credit against his personal tax liability the amount of corporate tax which was "withheld" by the corporation. The principal advantages claimed for this approach to integration are that it grants equal proportionate relief to all shareholders regardless of their income level, that it would provide for rebates in those cases where the credit claimed exceeds personal liability, and, finally, that the credit is available only in those cases where it has been generated by the recent payment of corporate income tax.

DEFICIENCIES OF INTEGRATION PROPOSALS

Discrimination against WHC's Two variants of "withholding" are suggested in the White Paper, one for CHC's and another for WHC's. In the case of the former, the entire corporate tax on dividends is withheld and credited against personal liability, while only one-half of the tax is withheld and credited in the case of WHC's. As a consequence, the combined corporate and personal tax burdens upon dividends distributed by WHC's will be greater than the combined burden upon dividends generated by CHC's. The combined rates for the two types of corporations are shown for shareholders with different personal tax rates in the following table:

Combined Corporate and Personal Tax Rate on an Additional Dollar of Dividend Income Received from a CHC and a WHC.

Marginal Personal Tax Rate of Shareholder	Combined Tax Rate On Dividend Received From: CHC	WHC
20%	20%	25 %
30	30	37.5
40	40	50
50	50	62.5

It is evident from the table that regardless of the marginal tax rate of the shareholder, the combined tax rate on dividends received from a WHC is 25% higher than the combined burden upon dividends received from a CHC.

It is clear that such a differential is inequitable and constitutes a significant deterrent to the owners of any closely-held corporation who are contemplating a public issue of their securities. (See Appendix "H" page 58.)

Growth Biases of Proposed Approach Any form of relief from double taxation which is tied to the payment of dividends will benefit only the shareholders of corporations that are in a position to pay dividends. In contrast, shareholders who have invested in corporations which are precluded by their stage of development from paying dividends, are in no way benefited by a relief device that is tied to the payment of dividends. Were such a relief device in fact utilized, its value would likely be capitalized and reflected in higher stock prices for the equities of mature and eligible corporations. The prices of these would therefore tend to rise. Such changes are likely to be to the detriment of other companies which, while they may have excellent growth prospects, are unlikely to be in a position to pay dividends for several years to come. Such future dividends which are uncertain as to time and amount will be severely discounted by investors. It is likely, therefore, that the use of a relief device which is tied to the payment of dividends will tend to depress the relative prices of the shares of non-dividend paying companies. The greater the relief device the more the bias.

Eventually, the changes in the relative prices of the equities for different types of corporations would tend to restore the relative attractiveness of the various types of securities. It will be the case, however, that the relatively lower prices for the non-dividend paying companies will make the raising of additional capital more difficult for them, while the higher stock prices occasioned by the relief device in the case of eligible dividend-paying companies will make the raising of capital easier for such companies.

We therefore conclude that the use of any relief device which is tied to the payment of dividends will tend to bias future growth in favour of the steady dividend-paying prospect and against the type of company which is still in that early stage of development which precludes the payment of dividends. If this latter type of company is held to be important to the development of the Canadian economy—and we hold that it is—then such devices must be used with caution. In particular, the more generous the relief provided, the greater is likely to be the bias in favour of the established type of corporation.

Administrative Complexity The third type of difficulty from which the proposed method of integration suffers is that of generating a substantial number of serious administrative problems. For example, should the White Paper integration proposals be implemented, it would be necessary for Canadian corporations to maintain detailed creditable tax accounts. The accounting for these would be complicated by the fact that not all of the corporate tax payments actually made would necessarily be chargeable to these accounts. This would be the case, for exaample, where the combined Federal and Provincial rates exceeded 50%, the excess above 50% not being creditable. It would thus appear that each tax payment would have to be analyzed, to identify the creditable and non-creditable portions.

Of greater significance from the point of view of the capital market, is the fact that the creditable tax available in a corporation would be significant information to a potential investor; but from the position of the corporation this would be difficult to compute and supply. Even with such information available, it is likely that the position of investors is going to be significantly complicated. This would be the case, for example, where the amount of creditable tax fluctuated more severely through time than did dividends. Since fluctuations in corporate profits tend to be absorbed by changes in retentions, rather than in fluctuations in the dividend rate, it is quite likely that the

projection of after-tax rates of return to the investor will indeed be complicated by the crediting process.

The constraint that creditable taxes must be allocated to shareholders within two and a half years is likely to be a source of further administrative difficulty. It is not difficult to visualize circumstances in which the two-and-a-half year limitation may be incompatible for example. with the requirements of senior financing, or even those of business prudence. Furthermore, it may not always be possible to circumvent such difficulties by resorting to the use of stock dividends. To some extent, at least, such dividends may possibly contravene the dilution clauses which are attached to a variety of financial instruments and also may result in lower stock prices.

Several other administrative difficulties would likely be generated by the widespread usage of stock dividends which the White Paper appears to contemplate. For example, stock dividends are a much costlier method of making distributions to shareholders than are cash dividends. It has been estimated that the issuance of cash dividends involves a cost of 15-20¢ per cheque. The stock certificates which would be required by a stock dividend cost approximately 75¢ each, and this cost would have to be supplemented by a charge of approximately 50¢ for clerical updating on investors' accounts. If registered mail were to be used there would be mailing charges of approximately 65¢ per account. It is thus quite apparent that the issuance of stock dividends is much costlier than the issuance of cash dividends. This cost differential would almost certainly preclude frequent resort to the use of stock dividends.

Since the conveyance of creditable tax by means of stock dividends, could be highly uncertain as to amount and timing, it would be difficult for the market to anticipate this by stock-price changes which reflect quite closely the likely value of the stock dividend.

In the case of WHC's the use of stock dividends would almost certainly result in the issuance of fractional shares. Trading in these would involve the inconvenience and cost of assembling whole units and marketable lots. The time and effort involved in this exercise would be substantial, and would tend to be reflected in lower prices for these fractional units.

Problem of Preferred Shares The existence of preferred shares is a source of potential difficulty to the proposed integration scheme. The claims of preferred shareholders to the income of a company clearly have precedence over the claims of the common shareholders. It is necessary to enquire, however, whether they should also have priority of claim to creditable taxes. In this context, it should be observed that when the dividend-received credit was introduced in the Budget Speech of March, 1949, the then Minister proposed that the credit be restricted to dividends received from the common shares of Canadian tax-paying corporations. By way of explanation, he stated:

> *"While I have used the expression 'common' shares, the law will actually confine the credit to the most junior class of shareholders of a company, and it will not be granted in respect of shares that enjoy any special preference. Generally speaking, the incidence of the corporate taxes is upon the common shareholders, and I believe that they rather than preferred shareholders should be granted such relief as can be given at this time."*

Underlying this decision was the belief that although preferred dividends are actually made from tax-paid income, the preferred shareholders' dividend is affected by the corporate income tax only in the event that after-tax income is insufficient to meet that dividend. In all other

circumstances, the preferred dividend is invariant with respect to changes in the corporate income tax, and the preferred shareholder cannot be thought of as being burdened by that tax. Rather, the burden is exclusively upon the common shareholder.

While the economic reasoning underlying the Minister's decision to restrict the dividend-received credit to common shareholders was correct, the decision was made in a supplementary budget in October, 1949, to extend the credit to preferred shareholders. This extension was dictated by the administrative problems of trying to draw a line between preferred and common shares. It should be noted that this extension of credit to preferred shareholders was in no way detrimental to the common shareholders—they still received the full credit which the Minister had first indicated. In contrast, under the White Paper proposals, it appears that each dollar of creditable tax allocated to the preferred shareholders is one less dollar available to the common shareholders.

We can readily visualize several situations in which there will be an insufficiency of creditable tax to cover all the dividends which a company may choose to distribute. In such circumstances, the allocation of creditable tax to the preferred shareholders may preclude the extension of relief from double taxation to the common shareholder. In consequence, if the White Paper proposals regarding integration were to be implemented, it would be necessary to establish the priority of the claim of the common shareholders to the creditable tax generated by a corporation. It is difficult to conceive of how this could be done without generating much more administrative complexity.

Negation of Incentive Devices We have alluded to situations in which earnings might be available for distribution, without there being any creditable tax which could be allocated to such earnings. This would occur, for example, in the case of companies where taxable income has been reduced as a consequence of their benefiting from Federal incentive programs which permit them accelerated depreciation or depletion allowances. In such situations, the companies might well have earnings available for distribution, but not covered by creditable tax. In consequence, distributions of such earnings to either corporate or individual shareholders would be subject to full taxation in the shareholders' hands. The net result would therefore be a negation at the shareholder level of an incentive granted at the corporate level, a result which surely has little to commend it.

The preceding paragraph refers to the possibility of incentive programmes giving rise to a deficiency of creditable tax at the personal level. More generally, in all situations where timing differences result in an insufficiency of creditable tax, the shareholder will face full personal tax rates without credit for the corporate tax which will be payable at some point in the future, or which may in fact have been paid in the past. Such differences influence the time—but not the fact—of tax payments, and do not result in tax avoidance. It would be most unfortunate if the necessity to generate adequate amounts of creditable tax were to prevent businesses from claiming capital cost allowances in excess of depreciation written in the accounts when there were sound reasons for doing so.

Stock Dividends and Control Blocks Where the retention of earnings necessitates the use of stock dividends, it is possible that this may work to the detriment of certain shareholders. This would be the case, for example, where a control-block shareholder finds himself in a position in which he cannot sell any part of his stock dividend. Since stock dividends would be in proportion to the outstanding shares of a company, any sale from the stock dividend must reduce the proportion of shares held by the shareholder. If this is incompatible with the main-

tenance of the shareholder's control position in the company, no real benefit will in fact have been conferred to him. Indeed, should the shareholder's personal tax rate be greater than 33⅓%, additional taxes would have to be paid upon the receipt of the stock dividend, and the necessary cash would have to be raised from some other source.

The preceding paragraph dealt with the situation in which the stock dividend might actually impose a hardship upon the holder of a control-block of shares. It is, of course, possible that rather than expose himself to this hardship, a shareholder who effectively controls a company may refrain from using stock dividends, preferring to let the creditable tax become stale-dated. The pursuit of this particular course would clearly be to the detriment of minority shareholders.

Income Locked in Subsidiaries Under the present tax legislation, the earnings of subsidiaries may be paid up to parent companies for use by these companies or by other companies in the group without the payment of corporate income tax. Under the White Paper proposals, such transfers would be taxable to the extent that there was insufficient creditable tax to offset the tax liability which would be generated. This requirement would seriously inhibit the mobility of capital between related firms. From the point of view of economic efficiency, it is desirable that capital be permitted to flow towards the highest potential rates of return. By discouraging these flows where there was an insufficiency of creditable tax, the White Paper proposals would militate against the achievement of Canada's full growth potential.

Shareholder-Owned Public Utilities There is one other area where we feel we should comment upon the White Paper integration proposals. This concerns the proposed treatment of shareholder-owned public utility companies. At the present time, and despite the fact that the Federal government turns over to the Provincial governments 95% of the corporation tax collected from these utility corporations, their shareholders are eligible to receive the 20% dividend-received credit which is extended to all shareholders in eligible Canadian corporations. It is argued in the White Paper that the Federal government ought not to provide relief to shareholders in corporations where that government does not retain the corporate tax paid. In consequence, it is proposed that these shareholders be deprived of the dividend-received credit which they now receive, and that they be excluded from participation in the integration proposals advanced in the White Paper.

It must be realized that the capital market responds to the total tax burden levied upon certain types of economic activity, without enquiring as to the jurisdictional division of that tax burden. Should the total tax burden upon shareholder-owned utility corporations be higher, as a consequence of exclusion from integration, than the total burden encountered by competitive investment opportunities, there can be little doubt that the prices of the public utility shares will tend to fall. This will make it much more difficult for these companies to raise the amounts of capital which will be necessary if they are to continue to grow at the rapid rate which will be necessary to meet the expanding energy requirements of the Canadian economy.

It is our opinion that if capital market distortions are to be avoided, the method of integrating corporate and personal income taxes must be as neutral as possible as between industries. In this respect, the integration proposals advanced in the White Paper regarding shareholder owned utilities are most unsatisfactory, and we would recommend the adoption of some alternative technique.

CONCLUSIONS REGARDING INTEGRATION

Our detailed consideration of the White Paper proposals for integrating the corporate and personal income taxes persuades us that these particular proposals are singularly inappropriate and would generate more problems than they would solve. We find that they discriminate in an unjustifiable manner between CHC's and WHC's; that they are likely to bias future growth in the direction of the already established corporations, and against those growing corporations which have not yet achieved the capacity for steady dividend payments; that they would be the source of many substantive administrative problems and complexities; and that they would create a number of other distortions to the capital market.

We therefore recommend that the White Paper proposals regarding the integration of the corporate and personal income taxes not be implemented. It is our opinion that a more suitable remedy lies in the modification of the existing dividend-received credit system.

ALTERNATIVE INTEGRATION PROPOSAL

We submit that the alteration most needed by the existing system involves the substitution of a graduated rate of credit for the present flat rate of 20%. It would be possible by selecting appropriate rates of credit to confer the same degree of relief from double taxation to all shareholders, regardless of their marginal tax rates. Such a graduated system would satisfy the equity requirements advanced in the White Paper, while avoiding the discrimination, bias, and other distortions generated by the White Paper proposals. A graduated scale which provides roughly the same relief at each taxable income level as the partial integration proposals of the White Paper is given below:

Taxable Income	Rate of Credit
None	50%
0—$4,999	37
$5,000—$9,999	33
$10,000—$15,999	30
Over $16,000	25

These rates of credit would, as indicated above, provide approximately the same relief as the partial integration proposals contained in the White Paper. This is still a device, however, in which the amount of relief is tied to the amount of dividends paid. In consequence, it too suffers from the defect of being biased against the non-dividend paying type of corporation which is so important to Canada's future economic development. To minimize this bias,

We recommend the adoption of a graduated dividend-received credit with rates ranging from, say, 25% for low-income investors, to possibly 15% for high-income investors. Such a credit would cost the Treasury approximately the same as the existing 20% credit and be substantially less costly in terms of revenue loss than would be the relief proposed in the White Paper.

It is our view that the saving which would result from the adoption of less generous integration proposals should be used to permit the implementation of a more modest capital gains tax. It is our considered opinion that the combination of a more modest relief from double taxation, together with a lower rate of capital gains tax, would cause the capital market to respond in such a manner as to promote a more satisfactory rate of development of our unexploited economic opportunities than would prevail were the White Paper proposals implemented.

CAPITAL GAINS TAX ON WHC'S AND CHC'S

In the following chapter the sort of capital gains tax structure which we think is most appropriate for Canada, given its present state of economic development, is set forth. There is, however, one aspect of the White Paper proposals regarding capital gains taxation which we believe should be commented upon here and that involves the discriminatory nature of the tax on gains on shares of WHC's and CHC's.

White Paper Proposals The White Paper proposes that gains realized from the sale of shares of CHC's be taken into taxable income in their entirety, while only one-half of the gains realized from the sale of shares of WHC's would have to be included in taxable income. In the case of the latter type of corporation, however, accrued gains would have to be determined every five years, and one-half of these taken into taxable income. In effect, therefore, a realization basis is proposed for gains on the shares of CHC's, while a combination of the realization and an accrual basis is proposed for gains on the shares of WHC's. Gains arising from all other assets would be treated in the same basic manner as those generated by the shares of CHC's.

Since the White Paper does not propose that there be a deemed realization at death, the realization approach proposed for CHC's would permit holdings in these corporations to be passed between generations without any application of the capital gains tax. With respect to the shares of WHC's, again there would be no deemed realization at death, but in this case, because of the operation of the proposed quinquennial revaluations, the absence of a deemed realization at death would typically be of little consequence. We therefore conclude that:

The discrimination proposed in the White Paper in the taxation of capital gains arising from the shares of CHC's and WHC's, together with the absence of any proposal for any deemed realization at death, constitutes yet another form of discrimination against the widely-held corporation and yet another deterrent to CHC's becoming WHC's. In our opinion, such results are both highly undesirable and avoidable.

International Implications We are also concerned about the international implications arising from the creation of two classes of corporations, to each of which different capital gains tax provisions are applied. In response to Federal government policy, certain Canadian subsidiaries of U.S. corporations have made shares available to the Canadian public. As a consequence, these companies would, under the White Paper proposals, be classified as WHC's, and placed at a tax disadvantage relative to those other U.S. subsidiaries which have been less responsive to the wishes of the Canadian government.

In effect, good corporate citizenship is to be rewarded by discriminatory taxation in the form of the five-year accrual provisions for capital gains for those foreign subsidiaries classified as WHC's but not those classified as CHC's.

Yet another type of discrimination could arise, this time between Canadian and non-resident shareholders in a WHC. This would emerge should Canada fail to renegotiate our tax treaties in such a manner as to permit the taxation of unrealized capital gains accruing to non-residents. Confronted with the dilemma on the one hand of choosing between types of discrimination, or the abandonment of the quinquennial revaluations on the other, the latter would appear to be the only satisfactory choice.

WITHHOLDING TAX ON CORPORATE BONDS

A minor point which should not be omitted from this discussion of the taxation of the corporation concerns the withholding tax on corporate bonds. Although the White Paper is concerned with reforming the withholding taxes on income flowing to non-residents, it does not question the application of the withholding tax to interest payments on corporate bonds. Since interest payments on government bonds are exempt, the bonds of the corporate sector are clearly discriminated against.

It may be argued that since the U.S., in particular, grants a credit for withholding taxes paid, there would be no benefit to the non-resident investor should Canada remove the tax. It should be noted, however, that a substantial number of U.S. institutional investors are non-taxable and so unable to claim the credit. Given the concern regarding foreign ownership in Canada, we submit that it would be desirable to encourage non-resident investors to invest in Canadian bonds rather than in equities. The removal of the withholding tax on corporate bonds would be a useful step in this direction, and one with relatively inconsequential revenue implications.

CONCLUSIONS AND RECOMMENDATIONS

The principal argument advanced in this chapter is that the proposals suggested in the White Paper would, if implemented, result in severe discrimination against WHC's.

The differing degrees of integration of corporate and personal income taxes proposed in the White Paper would certainly have this result, and so too would the different methods of treating capital gains arising from the ownership or sale of shares in the two classes of corporations. In addition, the proposed distinction between CHC's and WHC's is itself unsatisfactory in that it would undoubtedly generate anomalous results. In particular, it would result in the significantly different taxation of the profits of companies which are in immediate and obvious competition with one another. We submit, therefore, that this proposal is indefensible.

There can be little doubt that if the White Paper proposals regarding the taxation of WHC's and their shareholders were implemented, the net result would be a bias against such corporations sufficiently strong to serve as a major deterrent against companies going public. While the maintenance of the closely-held status might well serve to maximize the after-tax income of the owners, the cost to the economy could be substantial. By remaining closely-held, corporations would be in large measure denied access to the investment funds which are available to facilitate the growth of public corporations. There can be little doubt that it would be most unfortunate if any significant number of corporations were induced, by a non-neutral tax system, to adopt a status which would result in slower growth than would likely be attainable under a more neutral tax system.

It should be noted that an important consequence of tax pressures which cause companies to remain closely-held may well be an acute shortage of suitable investment instruments on the Canadian capital market. There is every indication that, even without the proposed tax changes, the next few years are likely to see the emergence of a shortage of suitable investment instruments on the Canadian equity market. It would be most unfortunate if this problem were in any way reinforced by a discriminatory tax system.

It is our view that many of the potential difficulties identified in this chapter could be avoided by the adoption of alternative methods of taxing corporations and their shareholders.

We recommend that the proposed distinction between closely-held and widely-held corporations be abandoned. As a general proposition, we think all corporate income should be taxed alike.

The one exception to this general rule is our recommendation that "small" corporations continue to have the benefit of the lower first-bracket rate and a partnership option.

In addition to the proposed abandonment of the distinction between CHC's and WHC's, we also recommend the continued use of a dividend-received credit as a partial offset to the double taxation upon corporate profits. We recommend, however, that a graduated credit be used, one with the rate of credit ranging from, say, 25% for low-income shareholders, to, say, 15% for high-income shareholders.

As was noted above, such a credit would grant approximately the same degree of relief from differential taxation for all shareholders, and would be less costly in terms of revenue lost than the integration proposals advanced in the White Paper. We suggested, too, that this saving be used to finance a form of capital gains tax which would be more conducive to the realization of our economic potential than the method of taxing gains proposed in the White Paper would be.

We submit that there should be no distinction between the method of taxing gains arising from the shares of CHC's and those arising from the shares of WHC's. If our recommendations regarding the distinction between the two classes of corporations be accepted, the basis of the discriminatory treatment would be removed.

It is our view that this alternative package of proposals dealing with the taxation of the corporation and its shareholders would avoid many of the difficulties inherent in the White Paper proposals. It is a package which is free from the serious discriminations that characterize the White Paper package, and one which is unlikely to have any adverse effect on the supply of equities available upon the Canadian capital market. For these reasons, we strongly urge that the package we have suggested be substituted for that proposed in the White Paper.

Chapter FOUR — THE TAXATION OF CAPITAL GAINS

SYNOPSIS

This chapter examines the type of capital gains tax which is most appropriate for Canada at this stage of its economic development. It is suggested that the particular variant of capital gains tax adopted should be one which (1) does not interfere unduly with the mobility of capital; (2) does not discourage Canadians from saving and investing current income or liquid balances; (3) does not create a bias against Canadians investing in Canada; and (4) acts as something of a deterrent to those who liquidate their investments for purposes other than re-investment.

It is submitted that the method of taxing capital gains advanced in the White Paper in fact scores rather badly in terms of these criteria.

The White Paper proposals involve a realization approach to the taxation of capital gains, the tax being exigible when the gains are realized by the sale of the asset giving rise to them. The one exception to this occurs in the proposed discriminatory treatment of gains generated by the shares of WHC's. This latter type of gain alone is to be taxed on a realization and accrual basis, the latter to be accomplished by quinquennial revaluation of the shares.

The White Paper recognizes that the proposed realization approach generates locking-in effects. The only offset to the locking-in effect is found in the proposed quinquennial revaluations of the shares of W.H.C.'s. In general the revaluations as proposed in the White Paper are vulnerable to many criticisms. In particular such revaluations discriminate in several respects against W.H.C.'s and Canadian investors and would lead to an increase in the number of Canadian firms taken over by non-residents and would deter companies from going public.

The rate of taxation proposed in the White Paper on capital gains is inappropriate for Canada at this stage of its development. It will discourage Canadians from saving and investing current income or liquid balances, and will have strong locking-in effects.

These considerations, among others, lead us to recommend against the implementation of the quinquennial revaluat ions and the proposed rate of taxation on capital gains.

As an alternative to the White Paper proposals for the taxation of capital gains, this chapter recommends that:

1. *Canada tax all capital gains in a uniform manner, one-third of such gains or losses being taken into taxable income in the year of their realization.*
2. *Under the capital gains tax a roll-over option be provided whereby the actual tax is deferred as long as the proceeds of liquidation are re-invested in eligible investments within a specified period of time.*
3. *To minimize possible locking-in effects and discrimination as between different types of assets generating capital gains, there should be a deemed realization of all accrued but untaxed gains upon the death of the asset holder, with the fraction of gains taken into taxable income to be one-half of that normally taken into income.*
4. *The burdens of capital gains taxes and estate taxes must be considered conjointly. To simply add the new capital gains taxes to the existing estate taxes would be to penalize Canadian capital unconscionably. In proportion to increased reliance on capital gains taxes, there should be decreased reliance upon death duties.*
5. *The combination of a capital gains tax and the higher existing personal tax rates would be excessive in the transitional period. Accordingly the higher existing personal rates should be reduced coincident with the imposition of the capital gains tax.*
6. *Valuation Day values be optionally the higher of cost or Valuation Day prices, in effect extending to other securities the treatment already proposed for bonds.*
7. *Suitable amendments be made to the White Paper proposals that all persons leaving Canada be required to pay a tax on any unrealized gain, in order to avoid difficulties the proposals create for those persons leaving the country temporarily or for health reasons and for temporary residents of Canada.*

We are confident that these alternative proposals would eliminate any significant locking-in effects without, at the same time, creating severe discrimination, inequity, and other problems associated with the quinquennial revaluations proposed in the White Paper. Under our proposals, capital could flow more freely in response to changing relative rates of return, and the inevitable result must be both a higher rate of growth of the Canadian economy and a higher yield for the capital gains tax. It should be noted that any possibility of an intergenerational deferral of capital gains tax would be removed by the deemed realization at death which we recommend be applied to all accrued, but untaxed gains.

GENERAL CONSIDERATIONS

Of the many tax structure changes advanced in Proposals For Tax Reform, none are more controversial or likelier to have greater impact on the capital market than those relating to the taxation of capital gains. In commenting upon these proposals, it should be clear that our primary concern is with the impact of the proposed method of taxing capital gains upon investment in Canada and by Canadians, and upon the efficiency of operation of the Canadian capital market. This should not be interpreted as implying a lack of concern on our part with the equity aspects of capital gains taxation. On the contrary, we accept the argument that inequity results where capital gains are totally excluded from the tax base. Rather, the emphasis evident in these comments is dictated by our recognition that while this inequity should be removed, the nature of capital gains tax introduced for this purpose must be as compatible as possible with the full realization of the growth potential of the Canadian economy.

Short-Term Versus Long-Term Gains Our comments in the following sections of this Chapter are largely concentrated upon what we consider to be the more negative aspects of the White Paper proposals. While, in considering the White Paper, focussing attention upon areas of disagreement is a more useful exercise for us to undertake, there is one area where we would be remiss were we not to make our agreement with the White Paper explicit. This concerns the lack of any proposed distinction between short-term and long-term gains.

Quite clearly, there is no meaningful economic distinction between gains which have accrued for six months less a day and those which have accrued for six months and a day. A dividing line of one year, or any other period, is equally devoid of economic content.

The investor should be free to choose the holding period which is most appropriate, given his needs and objectives, and no artificial distinction should be drawn between gains which have accrued over shorter and longer periods. We therefore support wholeheartedly the lack of discrimination between the tax treatment of short and long term gains which is implicit in the White Paper.

This neutrality is especially important in the context of a capital market which lacks liquidity. In such a market, there are occasions in which the short-term investor makes the market by giving it liquidity. A tax system which deters him from doing so would be most costly in terms of reduced capital market efficiency.

Criteria for Evaluating Capital Gains Tax Our several concerns regarding the impact of the form of gains tax upon investment in Canada by Canadians, upon the efficiency of operation of the Canadian capital market and upon the realization of our economic potential prompt

us to suggest that the various possible methods of taxing capital gains be appraised in terms of four criteria. These are:

1. ***the effect of the proposals upon the mobility of capital, i.e., upon the ability of capital to move to superior investment opportunities when these are available.***
2. ***the effect of the proposals on the willingness of Canadians to save and invest current income or liquid balances.***
3. ***a bias is not created against Canadians investing in Canada.***
4. ***the effect of the proposals upon the willingness of persons to liquidate their investments for purposes other than re-investment; e.g., for consumption or holding cash.***

It is our opinion that any method of taxing capital gains which does not score well in terms of these criteria is inappropriate in a young, capital-scarce country which has only begun to realize its economic potential. Unfortunately, it would appear that the White Paper capital gains tax proposals are defective in precisely these respects. Before commenting on this in greater detail, it may be useful to set forth in rather summary form the nature of these proposals.

White Paper Capital Gains Tax Proposals It is suggested in the White Paper that capital gains be treated as ordinary income subject to tax in the normal way. Capital losses would be deductible in computing income, and it would appear that if such losses in any year exceeded income, the resulting excess would be treated in a similar manner as business losses: they would be carried back one year or forward for five years, to be applied against the income of those years.

If this system were implemented, only gains accruing after "Valuation Day" would be subject to tax. In general, gains or losses are to be measured by reference to the fair market value of the taxpayer's assets on Valuation Day.

While most gains are to be brought into income at the time of their realization, the White Paper would treat differently gains arising from shares of WHC's. Such gains would be taxable on a realization basis, but, in addition, shareholders (other than WHC's) will be required to revalue their portfolios every five years, and take any accrued gain or loss into income in the year in which the revaluation occurs. It is also suggested that since the dividends of WHC's are to be subject to only partial integration, tax neutrality requires that only 50% of the gains or losses on widely-held shares be taken into taxable income.

Several of the suggested provisions relating to the international aspects of capital gains taxation should be noted. For example, the White Paper suggests that persons giving up their Canadian residence should be deemed to have disposed of all of their assets at the time of their departure from Canada, the resulting accrued gains or losses being taken into income in the year of departure. It is also suggested that, to the extent Canada's tax treaties with other countries permit, non-residents be subjected to tax on gains realized with respect to Canadian assets. It is proposed, however, that an exemption be provided in respect of gains on the sale of shares of a WHC where the non-resident owns less than 25% of the shares outstanding.

Before commencing the analysis of these proposals, there are two other provisions of the White Paper which should be noted. First, while the White Paper requires that any gains realized on the shares of CHC's be included in their entirety in the income of the vendor in the year in which the disposal takes place, it also provides that when

a taxpayer dies holding shares of a CHC, there will be no deemed realization on the assets. Rather, the estate or beneficiary takes over the cost basis of the deceased, and any tax on the gain is therefore postponed until the assets have been sold by the estate or beneficiary. An indefinite postponement of capital gains tax is thus possible in this case. Finally, in the case of shares of foreign WHC's held by Canadian residents, there is no requirement to accrue gains or losses on a quinquennial basis. Such gains or losses would be subject to inclusion in taxable income only when realized.

LOCKING IN EFFECT OF REALIZATION APPROACH

With the exception of gains arising from the holding or sale of shares of WHC's, the White Paper contemplates a realization approach to capital gains taxation. Despite the adoption of this realization approach by both the United States and by the United Kingdom, it is a method which is widely appreciated to suffer from the deficiency of generating strong "locking-in" effects.

A tax upon realized gains is tantamount to a tax upon capital transfers, and individuals are deterred from making otherwise desirable shifts in the composition of their investments.

Under these circumstances, it is necessary that the magnitude of the economic benefit to be derived by investment adjustments be appreciably larger, otherwise they will not occur.

Consider the case of an investor who sells for $100 a share in a WHC that was acquired at $50. At a personal income tax rate of 50%, the capital gains tax would be $12.50, leaving $87.50 for re-investment in a new asset. It would be necessary for this new asset to appreciate by 14.3% to restore capital to the $100 value which prevailed before realization. In addition, if the shares of the WHC were yielding 5%, the new asset—with only $87.50 available for investment—would have to yield 5.7% if the income stream is to be maintained at its former level. In short, an appreciation of 14.3% and a yield higher by 14.3% would be necessary to restore the investor to his pre-capital-gains-tax status. Unless potential benefits of at least this magnitude can be obtained from a new asset, the adjustment will not be made. It should be noted that the locking-in effect for assets other than shares of WHC's would be more than doubled (i.e., 33.3% vs. 14.3%).

Such effects are clearly powerful enough to have a significant impact on investment decisions. Should the investor be deterred by the tax from moving to an otherwise more attractive investment, socially desirable transfers of capital will not occur, and the economy as a whole, as well as the investor in question, will suffer.

A realization approach to the taxation of capital gains will prevent portfolio adjustments occurring unless potential benefits to be derived are sufficiently great. It is obvious that the potential gain to be derived from an adjustment must be greater (in order to make the adjustment worthwhile) than it would have to be without a capital gains tax. Thus, it follows the fewer will be the opportunities where advantageous adjustments could be made, and the more damaging, therefore, would be the effects on the economy.

It should be noted that the locking-in effect is likely to be particularly strong where indefinite postponement is possible, as is the case, for example where there is no deemed realization upon death. This is, of course, the treatment accorded unrealized gains at death in the United States and also that proposed in the White Paper. In the Canadian context, any locking-in effects are likely to be more serious than they are in the United States,

largely because of the relative illiquidity of the Canadian capital market.

The realization approach is also subject to the criticism that it tends to increase the magnitude of price fluctuations for securities. This result is produced by the reluctance of owners to sell when prices are rising (thereby incurring an otherwise avoidable tax on their accrued gains), and their increased willingness to sell when prices are declining (in order to benefit from a deductible capital loss). The net result is that prices rise further than they otherwise would during the upswing, and fall further than they otherwise would during the downswing.

Given the locking-in effect of the realization approach, it is apparent that it scores rather poorly with respect to evaluation criteria (1), relating to capital mobility, and (2), concerning the willingness of investors to save and invest. It does, however, tend to keep investments "frozen", and hence tends to discourage liquidation for consumption purposes.

WHITE PAPER RESPONSE TO LOCKING-IN PROBLEM

The White Paper, of course, recognizes the possibility of generating locking-in effects. The sole offset which it would provide to these effects is the proposed quinquennial revaluations of the shares of WHC's. Unfortunately, we do not know the relative importance of these shares as a source of capital gains. In the absence of a tax upon gains, there has been no pressing need to collect the relevant statistics. Study No. 19 of the Royal Commission on Taxation, The Taxation of Capital Gains, provides data which suggest that in the United States the sale of shares of WHC's probably accounts for approximately one-half of the gains arising from the sale of assets held for six months or more. Given the greater relative importance of private companies in Canada, it would appear that the proposed quinquennial revaluations would reduce the locking-in effects for assets that account for less than half of the potentially taxable gains.

For the assets generating the remaining gains, the locking-in effects are likely to be particularly severe because of the proposed inclusion of the entire gain in taxable income in the year of realization. We conclude, therefore, that:

Because the proposed method of taxing capital gains would reduce locking-in effects only in the case of the shares of WHC's the proposals would have a significantly inhibiting effect upon the transfer of assets in Canada. The mobility of capital will, in consequence, suffer.

DEFICIENCIES OF REVALUATION APPROACH

There can be no doubt that the benefit to be derived from refraining from realizing accrued gains is appreciably reduced by periodic asset revaluations, and the locking-in effects are thereby minimized. Unfortunately, the periodic revaluations are themselves likely to be a significant source of difficulty, especially given the form of revaluation proposed in the White Paper.

All forms of periodic revaluation are open to the criticism that the value changes which are identified at the time of revaluation may not correspond at all closely with changes in the ability of the asset owners to obtain the cash required for tax payments. This is likely to be especially true in the case of those assets that promise to yield most of their total return in the form of capital gains and which are largely unaccompanied by a substantial income flow. Since this is characteristic of the equities used to finance the early development of the natural resources which underlie much of our comparative advantage in international trade and our recent economic growth, and also those companies established for innovative purposes, this

deficiency of the revaluation approach is extremely serious in a Canadian context.

Portfolio Investors The lack of correspondence between accrued gains and the necessary income flow to pay the capital gains tax upon them poses a general problem, even in the case of portfolio investors. In some instances, such investors could be forced to sell some portion of their holdings to raise the necessary tax money.

Holders of Control Blocks The situation, however, is much more serious for the investor who holds a substantial proportion of the outstanding securities of a WHC. The sale of some part of such holdings may well result in the loss of control of the corporation, or be subject to the difficulty that a partial sale may bring about a severe impairment of value. The possibility of such outcomes certainly provides tacit encouragement to the undesirable practice of issuing non-voting shares.

It is also of some interest to speculate on whether or not the White Paper proposals have possibly opened up a new weapon which could be used in take-over attempts. This would be the case, for example, where manipulative trading on a thin market succeeded in driving up the price of a company's shares, thereby imposing a potential capital gains tax liability upon a possibly illiquid principal shareholder. Conversely, principal shareholders may attempt to drive the price down in order to minimize revaluation gains. In short, we are concerned that these proposals may give rise to manipulative trading of an undesirable sort.

There are further difficulties with the White Paper proposals regarding the quinquennial revaluations and the taxation of accrued gains. Possibly most important is the fact that provincial securities laws inhibit the freedom of an investor to sell from his holdings, where the investor's holdings satisfy the definition of a "control block".

Contrary to the implicit belief of the White Paper, such control blocks are not readily marketable, and sales from them are severely circumscribed.

A rather fundamental issue is that concerning the valuation of control blocks. If the market for the shares is not liquid, it is probable that market quotations will not accurately reflect the value which should be placed upon the shares held in a large block. Furthermore, it is well known that the sales of larger blocks are often negotiated at prices sometimes appreciably higher or lower than market quotations. We conclude, therefore, that:

Serious valuation problems would be generated by any attempt to implement the White Paper quinquennial revaluation proposals.

Shares Subject to Restrictions We also foresee significant difficulties arising in connection with escrowed shares. Potential difficulties caused trustees, life tenants, and holders of interests in other property held in trust are also likely to be formidable. As an example, we may cite the case of a trustee who may not be free to deal with a holding of shares, and thus may be incapable of selling a portion of these shares in order to provide funds to meet a tax liability in respect to an unrealized gain. The terms of the trust may direct that all income is to be reserved to a designated class of beneficiary, with the corpus to pass to a remainderman after the happening of a particular event. If a tax is to be paid on the unrealized gain, there may be problems in determining who should bear the tax, i.e. the life tenant or the remainderman.

Discrimination Against WHC's The criticisms which have been identified so far are general in the sense that they apply with approximately equal validity to virtually all proposals for periodic revaluation. There is, however, an additional criticism which is quite specific to the particular revaluation scheme proposed in the White Paper and to

which we have referred earlier. That is, the deficiency that the revaluations would apply only to the shares of WHC's. This, of course, constitutes a significant discrimination against such corporations and their shareholders, a discrimination which it should be noted, is not offset by the requirements of the full inclusion in taxable income of capital gains enjoyed with respect to other assets.

The White Paper proposals for periodic revaluation are also subject to the criticism that they discriminate in several respects against Canadian investors and investment in Canada.

International Defects of White Paper Proposals The White Paper does not propose to require the periodic revaluation of foreign securities which are held by Canadian investors. A realization approach alone would be used in the case of these securities, and any resulting locking-in effect would be particularly unfortunate since it would involve the locking-in of funds in non-Canadian investments. It would, of course, be possible to avoid the capital gains tax for protracted periods by investing, for example, in a foreign mutual fund, and it is possible that the White Paper proposals would actually have the effect of encouraging the establishment of such funds in other countries and with scarce Canadian capital being utilized for this purpose. Such funds would, of course, permit the rolling-over of investments, without any capital gains tax being incurred.

The international aspects of the proposals are a source of several other difficulties. We have already referred at page 23 in Chapter III to the discrimination which would result should Canada fail to renegotiate our international tax treaties so as to permit Canadian taxation of realized and accrued gains experienced by non-residents who own interests in excess of 25% in WHC's. Recent French experience in renegotiating their tax treaty with the U.S. does not lead us to be sanguine about Canadian prospects in this matter.

Were Canadian renegotiations to fail, we might well have a situation in which the shares of WHC's were worth more to non-residents than to Canadians. This would certainly be the case for those growth-oriented WHC's which are not paying significant dividends (and therefore not generating the benefits of integration) but which are likely to generate capital gains. (See Appendix "G" page 57).

We conclude, therefore, that an increase in the number of Canadian firms taken over by non-residents will be the inevitable consequence of any failure to renegotiate these tax treaties along the lines suggested in the White Paper.

It is of some interest, too, that non-residents with interests of less than 25% in WHC's would not be subject to quinquennial revaluations. This freedom from revaluation would facilitate the acquisition of interests up to 25%, and these, it should be noted, may well convey effective control of the corporations involved. Even where such a share does not convey effective control, it most certainly provides an excellent base from which to acquire such control.

In the preceding paragraphs we have outlined major defects in the proposed revaluation approach. In general, the approach scores badly in connection with the specified criteria, is discriminatory and inequitable. Accordingly, we are convinced that it is not in the best interests of Canada and of Canadian investors. We, therefore, recommend against its implementation.

THE NEED FOR AN ALTERNATIVE APPROACH TO THE TAXATION OF CAPITAL GAINS

The argument presented so far has endeavoured to demonstrate the White Paper proposals for the taxation of capital gains suffer from several defects:

They discriminate in their treatment of gains arising from the shares of WHC's as against those arising from all other assets

They serve to deter CHC's from going public

They are likely to generate significant locking-in effects as a consequence of their reliance upon a realization approach and the omission of any deemed realization at death

The quinquennial revaluations which they propose in order to minimize locking-in effects are themselves fraught with difficulty

The outcome of the attempt to implement these proposals would involve discrimination against Canadian investors, especially in the case of those who invest in companies where the benefit to shareholders is likely to be predominantly in the form of capital gains, rather than in dividends—i.e., in growth companies.

It should perhaps be observed that this last problem assumes particular importance in the light of the Prime Minister's expressed view that Canadians ought to invest in the future, rather than endeavour to purchase back the past.

Given these serious problems, we would recommend that some alternative method of taxing capital gains be adopted for Canada.

A MORE ACCEPTABLE APPROACH TO CAPITAL GAINS TAXATION

Neutrality An extremely important question in the field of capital gains taxation is that of the percentage of capital gains or losses which should be taken into taxable income. The White Paper suggests that, in the case of WHC's 50% is appropriate, while in the case of gains generated by all other assets, the appropriate percentage is 100%.

We would stongly recommend that the capital gains tax adopted in Canada be neutral as between different forms of investment in the sense that the same percentage of the gain or loss should be included in taxable income, regardless of the asset which was the source of these gains or losses.

Rate of Tax The United States has chosen to include one-half of taxable gains in income, and we feel that this gives some indication of the level which would be appropriate for Canada. In this context, it must be kept in mind that the Canadian economy is at a significantly different stage of economic development than is that of the United States. Ours is a younger, more capital-scarce country, and one which abounds in substantially unrealized economic opportunities. If these are to be developed to the benefit of all Canadians, it is imperative that our scarce capital resources be utilized as effectively as possible. It is our opinion that this will not be done if the rewards for assuming the risks associated with investment in a young, dynamic economy are not commensurately high. We conclude, therefore, that:

The percentage of capital gains or losses which ought to be included in taxable income in Canada should be appropriately less than it is in the United States and other mature economies. We would recommend that the appropriate percentage would be that one-third of such gains or losses be included in taxable income.

The absence of any capital gains tax whatever in such other developing countries as Australia, New Zealand, South Africa, and Japan suggests to us that the requirement to include one-third of capital gains in taxable income is as far as Canada dare go at this time.

The Roll-Over Approach to Capital Gains Taxation In addition to recommending the inclusion of one-third of capital gains or losses in taxable income, we would recommend that this be implemented in conjunction with the so-called roll-over approach to the taxation of capital gains. Essentially, this would permit the investor to determine the timing of tax payments upon capital gains, the actual tax upon realized gains being deferred as long as the proceeds of liquidation of capital assets are invested, within a specified time period, in other eligible investments. Should the funds be used for purposes other than reinvestment, a taxable realization would be deemed to have occurred, and the capital gains tax would then be applicable.

DISCUSSION OF ROLL-OVER APPROACH

The roll-over concept is not, of course, a new one. It has been in use for some time in the United States where gains resulting from the sale of a residence are not taxed if re-invested in another residence within twelve months. In addition, the recognition of gain is deferred in some cases in the United States where productive real assets are exchanged for one another. The White Paper itself proposes to use the roll-over method with respect to certain situations where there have been forced realizations or where there has been no change of underlying ownership even though there has been a sale. It also suggests that "It may still be possible later to identify more situations in which a rollover can be granted without permitting taxpayers to accomplish tax free in an indirect manner what would be taxable if done directly." (Para. 3.51).

Since the White Paper provides this limited recognition of the roll-over concept, it is necessary to enquire why a more general usage is not contemplated. Unfortunately, the White Paper itself sheds little light on the subject, observing merely that the roll-over approach cannot be used for the shares of WHC's for the reason that "Since gains on the sale of those shares would only be 50% taxable and losses only 50% deductible, the provisions necessary to achieve the appropriate ultimate result would be too complex." (Para. 3.47).

The complexity of recording accrued taxable net gains would not appear to be particularly formidable and it would not seem unfair to suggest that we ought to have here a Scottish verdict of "not proven". Indeed, the accounts which would be necessary to record the capital gains or losses on all transfers, determine the fraction of these which would be taken into taxable income, and keep a running total of the net result, seem to be relatively straightforward. It is thus difficult to believe that accounting complexity is the major obstacle to the utilization of the roll-over approach to the taxation of capital gains.

Advantages of Roll-Over Method The principal advantage to be derived from this approach to capital gains taxation is that it in no way penalizes economically desirable capital transfers. In consequence, the incentive to save is in no way impaired, while net disinvestment is most decidedly penalized. The roll-over approach scores well on all four of the criteria for evaluating a capital gains tax. Under the roll-over approach the capital market would be free to perform its function of allocating scarce capital resources where the need for them is greatest (and the rate of return therefore highest), and this—by promoting a more rapid rate of growth of the Canadian economy—must work to the benefit of all Canadians. It should be noted that the advantages of the roll-over method are heightened by the characteristic lack of liquidity of the Canadian capital market.

An additional advantage to the roll-over approach is that since it would permit investors to move their funds freely in response to changing relative rates of return, the rate of capital appreciation would be greater; in consequence, the

long-run yield of the capital gains tax would be larger under a roll-over approach than it would be if the method suggested in the White Paper were implemented.

Were a roll-over approach to capital gains taxation to be adopted, the yield of the tax would emerge in the longer run as investment accounts were closed out, either for purposes of consumption or as a consequence of deemed realization upon the death of the holder of the account. This, of course, does not mean that the yield of the capital gains tax will be deferred for a generation. Rather, the yield would emerge progressively as withdrawals from the roll-over investment accounts were made for consumption purposes, or as they were closed on the death of their holders. Since this will be occurring in a continuing manner, the yield would emerge on a continuing basis.

It should be noted that the general use of roll-over accounts would tend to reduce the disruptive influence of the tax-loss sales which would likely occur under the White Paper proposals. Under these proposals, investors holding assets with accrued losses would be encouraged to realize on these in order to generate capital losses to offset other taxable income. Were these same assets held in a roll-over account, any such losses would have to exceed accumulated gains before a benefit would be derived. Tax-loss sales would therefore be a less significant factor in the market place.

The alternative solution to avoid tax-loss sales would be to permit a deemed realization of losses in lieu of actual sales. This would avoid the maneuvering that takes place in the United States at year-end.

Criticisms of Roll-Over Method

In discussions of the principle of the roll-over approach three objections are frequently raised. The first objection is that the roll-over approach is defective in that, since it permits the capital gains tax to be deferred, the taxpayer can benefit from the use of the deferred liability. This criticism is not, in our opinion, a very telling argument against the roll-over. In the first place, it is not an argument which is unique to the roll-over approach: any method of taxing gains (including that suggested in the White Paper for gains arising from all assets other than the shares of WHC's) other than by means of periodic revaluation would also confer the benefit of permitting the use of the deferred gains tax. Under the White Paper realization approach, for example, the taxpayer can have the use of the deferred tax upon his gains simply by refraining from realizing on them. In this case, not only does the taxpayer have the use of the tax upon the deferred gain, but additionally, a socially desirable capital transfer will not have occurred. This latter criticism would not apply to the roll-over approach.

Those who advance this particular objection argue that the deferred tax liability is a benefit to the taxpayer and reduces government revenue. In the first place these arguments are more than offset by the socially desirable benefits, outlined previously, which would accrue from the roll-over approach. Further the same arguments can be advanced against the proposals in the White Paper, which let it be repeated, have the same consequences by their treatment of gains arising from all assets other than the shares of WHC's. In addition the government for years has permitted the deferral of tax when an economic purpose is to be served and has not placed any burden upon the taxpayer for this deferral nor has it been concerned about short term loss of revenue. Considerations of short-term yield should not be a major determinant or influence when a nation's tax structure is being altered in a fundamental way. If the yield of the system is held to be inadequate in the short run, the appropriate remedy is surely found in an alteration of the rates of the existing taxes. The

structure of new taxes, on the other hand, should certainly be dictated by the goals which the tax system is intended to achieve in the longer run, and not by reference to considerations of short-term yield. Lastly if the taxpayer can transfer his assets from one investment to another free of any immediate tax burden, he is more likely to make such transfers, resulting in the long-run in a much larger total of capital gains subject to tax and greater revenue to government. (See Appendix "J" page 65).

The second criticism of the roll-over method which we shall note is that which observes that by appropriate manipulation, the taxpayer may arrange indirect, but tax-free withdrawals of his gains by pledging the underlying assets against loans used for consumptive purposes. Whatever the validity of this criticism, it has greater significance in the case of the realization approach proposed in the White Paper than it has in the context of a roll-over method. In the former case, the asset holder can defer the capital gains tax by refraining from realizing on his assets, but still use these assets as security for loans made for consumptive purposes. While the roll-over approach may suffer from the same defect, it at least has the very substantial virtue of permitting socially beneficial capital transfers to occur.

The final criticism of the roll-over approach is that while it has economic benefits and does score well on the four criteria, it is available only to those who have already acquired some capital which can be rolled-over. There are two observations we would make regarding this criticism. First, it should be realized that as long as the assets in the roll-over account are kept invested, there is no consumptive benefit accruing to the holder of the account, while their productive use does generate social benefits. Secondly, the roll-over approach would greatly facilitate the accumulation of savings by those who are prepared to sacrifice present consumption for this purpose. It is precisely this group, who should be given every reasonable encouragement in starting to accumulate savings, who would be most severely penalized by a capital gains tax of the sort proposed in the White Paper.

We suggest that one means of encouragement would be to provide a tax incentive to this group to embark upon a plan of regular savings in a roll-over program.

If, despite the benefits which accrue to the economy from the roll-over approach, coupled with the encouragement that we suggest should be given to those who are prepared to sacrifice consumption for savings, it is still felt that the approach is inequitable then the objection is not without remedy. In the first place it would be possible to require the payment of an interest charge for the use of the deferred tax upon the gains. Alternatively the making of a modest annual payment could be required from those who exercise the roll-over option when the account exceeds a specified figure.

Assets to be Included in Roll-Over Accounts

Were the roll-over approach to the taxation of capital gains to be adopted, it would be essential that the class of eligible assets for inclusion in the roll-over account be broadly defined. If the capital market is to function effectively, it is imperative that funds be free to flow from one sector to another, to take advantage of changing relative rates of return. It would thus be desirable that investors be free, within their roll-over accounts, to move their funds among equities, bonds and mortgages. There may well be other forms of productive investment which could also be included in a roll-over account. The assets mentioned here—equities, bonds, and mortgages—have been singled out merely because they fall most clearly within the area of competence of this group.

As long as the proceeds of liquidation are re-invested in these eligible assets, we recommend that the capital gains

tax liability be deferred until such time as the proceeds of liquidation are used for some purpose other than such re-investment. At the time, it would be presumed that any withdrawal from the account was a withdrawal first of all against net accumulated capital gains. A capital gains tax would then immediately apply.

In whatever form of capital gains tax is adopted in Canada, we recommend that a roll-over option be provided. This particular method has the considerable advantage of minimizing the impediments in the way of socially useful capital transfers. It is thus least likely to have serious adverse effects upon the future growth of the Canadian economy.

FURTHER CAPITAL GAINS CONSIDERATIONS

Deemed Realization at Death The roll-over account does, of course, permit the deferral of capital gains taxes on assets held in the account. Were there no deemed realization at death, not only would the deferral of capital gains taxes be possible during the lifetime of the person holding the account, but also an inter-generational deferral would be possible. Under these circumstances, it may well be argued that the capital gains taxes would be totally ineffective.

It must be noted that the possibility of indefinite postponement of the capital gains tax is not limited to gains accrued in a roll-over account. Under the White Paper proposals, all gains unrealized at the time of death would not be subject to the capital gains tax. In consequence, it would be possible to hold the shares of CHC's until death, thereby avoiding any capital gains tax upon them. Similarly, one could purchase the shares of a non-Canadian "growth" company, and hold onto these until death. In both of these cases, there would be no realization, and so no application of the capital gains tax. In particular, since the capital gains tax does not apply, the requirement to include 100% of the gains on these assets in taxable income is inoperative, and not, therefore, an effective offset to the quinquennial revaluation proposed for the shares of WHC's.

It should also be noted that the absence of a deemed realization would, under the White Paper proposals, confer little benefit to the holders of shares of WHC's: since accrued gains on these would have been taxed quinquennially, there would, on average, be no more than two-and-a-half years' appreciation escaping taxation as a consequence of the absence of a deemed realization. The omission of such a realization would therefore confer little benefit to holders of shares of WHC's, and the offset to the quinquennial revaluation—the required inclusion in taxable income of 100% of capital gains derived from all other assets— would be totally inoperative where these gains are unrealized at the time of death.

Under these circumstances, the discrimination against the holding of the shares of WHC's is quite apparent, as is also the tax deterrent against CHC's going public. The locking-in effects which would be associated with the desire to avoid the tax upon realizations should also be evident, especially in the case of more elderly investors and asset holders.

It is our opinion that a more neutral, less discriminatory system would emerge if accrued gains upon all assets upon which capital gains are exigible were subject to a deemed or constructive realization upon the death of their holders. Such a realization would substantially reduce any locking-in effects, and would minimize the effects of tax considerations in shaping investment decisions. This would be especially true were the deemed realization coupled with our other recommendation for a uniform taxation of all gains, regardless of source.

Tax Applicable on Deemed Realizations Were a deemed realization at death adopted, it would be necessary to consider the tax which should apply. There are, in our opinion, two considerations which suggest that the burden of tax on deemed realizations be lower than that which applies to ordinary realizations. In the first place, the assets subject to deemed realization at death will also be taxable under the estate taxes. The full application of both taxes would result in extremely onerous burdens.

The second factor which suggests a lower effective impact of capital gains taxation in the case of deemed realizations stems from a consideration of the purposes of capital accumulation. While some accumulation is undertaken with the intent of building an estate for one's heirs, we submit that the primary purpose of most accumulations is to offset to some extent the life-cycle pattern of income. Recognizing that the flow of income varies significantly in the course of one's lifetime, people in general tend to accumulate surplus income during the peak earning periods, this accumulation being intended to permit the continuation of a higher level of consumption than would otherwise be possible during the years of declining income.

Where realizations are actually made, there is some presumption that some consumption benefits are enjoyed. These are, in effect, the offset to the sacrifice incurred at the time of saving. Obviously, there are no consumption benefits present where there are deemed realizations at death, and this suggests to us that gains which become exigible as a consequence of a deemed realization be subject to a lower tax burden on the estate than gains which emerge during lifetime. We therefore recommend that:

1. ***there be a deemed realization of all accrued but untaxed capital gains at the time of the death of the asset holder; and***

2. ***The capital gains tax paid upon a deemed realization at the time of the death of the asset holder be reduced by providing that the fraction of gains taken into taxable income be one-half of the fraction of gains normally taken into taxable income during the lifetime of a taxpayer.***

Should our recommendation on page 35 be accepted that one-third of capital gains be taken into taxable income, this recommendation would suggest the inclusion of one-sixth of gains in taxable income as a result of a deemed realization on death.

Relation of Estate Taxes and Capital Gains Taxes The existing estate tax system in Canada was established at a time when no capital gains tax was included in the Canadian tax structure. Now that it appears such a tax is to be added to the structure, it is imperative that the weight or burden of the estate tax system be reconsidered. If this burden were held to be appropriate in the absence of a capital gains tax, then most certainly it can no longer be looked upon as being appropriate once the capital gains tax system has been introduced.

It is imperative that the burdens of the capital gains tax and the estate taxes be considered conjointly. Canadian estate taxes are already appreciably more burdensome than those of the United States. To simply add the new capital gains tax to the existing unadjusted estate tax system would be to penalize Canadian capital unconscionably, and this can only be to the detriment of the future growth of the Canadian economy and the future standard of living of all Canadians. (See Appendix "I" page 63)

We recommend that consideration be given to the proposal in the White Paper attached to the Ontario Budget of 1969. There it was proposed that, in proportion to the degree of reliance upon capital gains taxes, there should be decreased reliance upon death duties.

Deemed Realization on Leaving Country Another potential difficulty concerns the cost to Canada of the proposal to require all persons leaving Canada to value their assets and pay a tax on any unrealized gains.

In our view, some arrangements would have to be made for those residents of Canada who are leaving the country temporarily. Such persons should be provided with some method whereby they would not be required to pay a tax on unrealized gains. This might be accomplished, for example, by granting them the option of providing security against the tax otherwise payable, or alternatively permitting them to continue to file tax returns as residents of Canada.

It is also necessary to express our concern over the position of non-residents who might come to Canada on a temporary basis to serve a period of employment with a Canadian employer. The imposition of a tax on unrealized gains for such persons could be particularly burdensome, and might well cause them to decline a Canadian posting. For such persons, the unrealized gains might arise with respect to assets of which they were not free to dispose. These might include such things as shares of the employer corporation, rights under employer incentive or retirement plans, and foreign real estate such as residences in their country of origin.

To avoid difficulties and inequities, we recommend that Canada not apply any deemed realization rules to persons who have worked in Canada for periods of up to, say, five years.

We recognize that some provisions are necessary to prohibit the avoidance of tax by persons who may move from Canada to tax havens. However, an inflexible rule imposing a deemed realization on persons leaving Canada permanently may not be equitable in all cases, for example, elderly persons leaving Canada for health reasons. We feel that proper safeguards can be devised to allow flexibility in such cases.

Interim Personal Tax Rates We are also concerned about the White Paper proposal that personal income tax rates be maintained at current levels in the first year of the new system with the higher rates being reduced over a five-year transitional period. Should the higher of the present personal income tax rates be maintained, capital gains during the transitional period may be subjected to personal income tax at rates which in the first year, could exceed 80%. There can be no question that the application of rates of this magnitude would be excessively high and would generate serious locking-in effects. This suggests to us the urgency of reducing these higher personal tax rates at the earliest opportunity.

The explanation offered in the White Paper for the maintenance of the higher rates is that the reduction of high rates of personal income tax ought to be coupled with other transitional provisions in such a manner that the reductions would coincide with the maturing taxation of capital gains.

We see no validity in this argument. It applies only to the revenue side of the tax picture and has no relevancy to the burden which may fall upon the taxpayer. Even on the revenue side it must be noted that in the first year alone the anticipated revenue from the taxation of capital gains is more than double the revenue loss which would ensue from the immediate reduction in the top rates of

personal tax and by the fifth year, the anticipated revenue from the taxation of capital gains is ten times that amount.

Cost Basis for Capital Gains A problem which warrants comment concerns the cost basis for the calculation of capital gains. The White Paper proposes to disregard the cost of shares when establishing Valuation Day values. Unfortunately, severe inequities will result when an investor is taxed on a "gain" some or all of which is, in fact, a recovery of capital. It is generally true, for example, that in periods of rising interest rates, dividend-paying securities owe some of their market losses to this factor, reacting in somewhat the same manner as bond prices. This is especially true of such interest-sensitive securities as preferred shares and shares of public utility issues. In such circumstances, investors may have to sell shares at a loss in order to pay taxes on the "gain" as measured from the Valuation Day values.

In order to avoid hardship to many long-term investors, consideration of fairness suggest that Valuation Day values be optionally the higher of cost or Valuation Day prices. There should also be a proviso that in claiming a capital loss for tax purposes, the lower of cost price or Valuation Day price must be used by persons using such an option. This would simply extend to other securities the sort of treatment already proposed for bonds.

CONCLUSIONS

In this chapter of our submission, we have worked upon the assumption that the important issue facing Canada today in the area of capital gains taxation is not that of whether we should, in fact, have such a tax, but rather what particular form or variant of capital gains tax should be adopted, and what level of rates should be utilized. Certainly there are formidable difficulties in formulating a method of taxing capital gains that does not blunt the incentives to save and invest, and which does not impede useful capital transfers. It would appear, however, that the particular methods advanced in Proposals for Tax Reform are singularly inappropriate for a young, capital-scarce country such as Canada.

We have endeavoured to demonstrate the deficiencies of the combined realization-revaluation approach suggested in the White Paper for the taxation of capital gains. Major defects were identified in the proposals for the discriminatory quinquennial revaluation of the shares of WHC's and in the proposals which would constitute deterrents to CHC's going public. It was recommended that the criticisms against the periodic revaluations warranted the abandonment of this proposal. In its stead, we recommended the inclusion in taxable income of one-third of capital gains or losses arising from all classes of assets, and the adoption of an optional roll-over approach to the taxation of capital gains. We also recommended that there be a deemed realization of gains at death, to which a reduced rate would apply, and that the burdens of the capital gains tax and the estate taxes be considered conjointly. We further recommend that the level of the latter should be reduced to reflect in an appropriate manner the consequences of the introduction of the capital gains tax.

All of these recommendations reflect our strongly-held opinion that, at this stage of Canada's economic development, it is imperative that we have a freely functioning and efficient capital market. In such a market, capital would flow in a manner which would tend to reduce or eliminate differences in the rates of return to be earned in different segments of the market. These differences are, of course, the market economy's way of signalling the need for a re-allocation of resources. This re-allocation will occur only where the benefit to be derived is sufficiently large. Where the cost of capital transfers is sub-

stantial, substantial differences in the rates of return will be necessary before appropriate capital flows will be induced. The implementation of the White Paper proposals would have the effect of increasing the differences in the rates of return to be earned in different sectors of the economy, and the efficiency of the price mechanism, as it applies to the capital market, would be seriously impaired and the growth of the Canadian economy would suffer. It is our firmly held opinion that these damaging effects would be of less consequence under the proposals advanced here than they would be were the White Paper recommendations implemented. On the other hand, it is our view that the proposals advanced here would not differ significantly in their equity implications from those suggested in the White Paper.

In conclusion, we would emphasize once more the absolute necessity of an efficiently functioning capital market for Canada at this stage of its economic development. All of the specific objectives of tax reform listed in Chapter II depend in large measure, upon the achievement of this efficiency. In addition, it should be apparent that the continued development of our economy is predicated upon substantial inflows of capital from abroad. Since this capital has typically entered in the form of direct investment, the benefits which it generates are purchased at a significant cost in terms of foreign ownership. While we cannot dispense with these capital inflows at this time, we should strive to minimize the associated costs by mobilizing Canadian capital as effectively as possible.

This effective mobilization will require a tax structure which yields rates of return which are appropriate to an economy characterized by the risks associated with rapid change and dynamic development. If these are not forthcoming, or if the allocative functions of the capital market are unduly interfered with, the result must be a failure to realize the full potential of the Canadian economy and society.

Chapter FIVE — GENERAL COMMENTARY

The earlier Chapters of this Submission were devoted to detailed analyses and appraisals of particular recommendations advanced in the White Paper. In contrast, the observations offered in this final chapter are of a more general nature, their concern being with the White Paper as a whole.

White Paper Technique The first observation we should like to make concerns the use of the white paper technique in the reforming of a tax system. We feel that this approach to tax reform has much to commend it, and we hope that the precedent established by this White Paper will be repeated in future years when further tax or other major reforms are under consideration.

The responses so far elicited by the White Paper will make possible the implementation of a more satisfactory package of reform than would otherwise have been possible. Potential sources of administrative difficulty have been identified and basic principles have been subjected to painstaking scrutiny. These processes cannot help but improve the final product and this must be to the benefit of all Canadians. We would hope, however, that the process of public involvement will not end with the White Paper. Legislation must now be written and we would recommend a final opportunity for public involvement before it is enacted. The most useful process is probably one which next involves the introduction of detailed draft legislation and regulations in which administrative matters could still be adjusted. In this way the process initiated by the White Paper could be brought to its logical conclusion.

Need for Further Reform It is our belief that the present process of tax reform will not determine once and for all the most appropriate tax structure for Canada. While the tax system undoubtedly influences the nature and level of economic development, the system itself ought to be a function of the degree of economic development which has already been attained. In other words, one should expect that the tax structure which is most appropriate at one stage of development will not continue to be the most appropriate when the degree of economic maturity has been significantly altered. In this respect, the underlying philosophy of the White Paper would appear to be at fault, for it seems to suggest that hereafter nothing more serious than minor adjustments will be required. This might well be correct were the authors of the White Paper dealing with a fully mature economy. It is obviously not true, however, in the case of Canada. Here, we have abundant and unrealized economic opportunities, and, relative to our potential, the Canadian economy is in many ways still undeveloped. This suggests to us that considerable weight ought still to be given in our tax system to features which positively foster and encourage growth. Unfortunately, such features are conspicuous in the White Paper mostly by their absence.

Question of Yield One issue which concerns us is that of yield. The White Paper itself suggests that apart from the recommendations relating to the mineral industries, the full implementation of the proposed changes would increase the yield of the tax system by some $630 million. In contrast, estimates made by the Province of Ontario suggest that the increase in yield (in this case including the changes relating to the mineral industries) would be something of the order of $1.3 billion.

Disregarding the question of the accuracy of these two estimates, we must observe that it is most unfortunate that the White Paper mixes considerations of tax reform with those of yield. The assessment of the economic effects of the former is an extremely difficulty exercise, and one cannot help but regret that it has been complicated by the need to assess the likely consequences of simultaneous and substantial increases in yield. There is, furthermore, the whole question of the appropriateness of changing yield without, at the same time, providing any indication of the likely method of spending the increased yield. The only way in which one can respond intelligently to a proposed change in tax yield is by knowing the method or manner in which it is to be spent.

Canadian-U.S. Tax Relationships The further deterioration of the Canadian-U.S. personal tax relationship proposed in the White Paper is a source of concern to us. Our anxiety regarding this matter is little relieved by the suggestion that economic differences are probably best offset by adjusting pay scales "for those individuals or scarce categories who must be retained or attracted against U.S. competition" (Para. 8.39), and not by juggling the tax system. This reasoning is guilty of ignoring the fact that tax differentials make competition for such persons more difficult and costly to Canadian firms. Even where they succeed in offsetting tax disadvantages by means of higher salaries, the method used would tend to raise Canadian unit labour costs relative to those of the United States. Surely this is not desirable.

Staging Reforming the tax system of any country is clearly a hazardous undertaking. There can be little argument that a well-conceived tax system can be both just and a potent force in stimulating and directing the development of the economy. Ill-conceived reforms, however, are capable of doing irreversible damage to the economy, and the cumulative effects of several such reforms could be incalculable. We would emphasize once more that under these circumstances the least hazardous method of implementing reforms is one which would phase them in, by

stages. Only in this way would the economy have the opportunity to adjust to one major change before it is confronted with another. This technique would permit the avoidance of the adverse effects of rapid and substantial adjustments, while retaining for the policy-makers a significant element of flexibility. It is the approach which we would recommend for Canada.

INSUFFICIENT ATTENTION TO GROWTH

More generally, we find it difficult to escape the conclusion that insufficient importance has been attached by the authors of the White Paper to the promotion of growth in the Canadian economy. This is made clear by the severity of the proposed impact upon savings in general, and by the nature of some of the tax structure changes recommended. To us, this is a cause for considerable concern.

Damaging Effects on Savings Although we do not know how the Government proposes to spend the additional revenue which the White Paper tax system would produce, there is one aspect of the change upon which we can comment. In general, the changes proposed in the White Paper impinge with greatest severity upon savings, both personal and corporate. It is suggested, for example, that $525 million of the increased yield of $630 million will be at the expense of private savings. Were this a once-and-for-all reduction we would not be unduly alarmed: however, it is merely one of a series of annual reductions which will have a significant cumulative effect upon the magnitude of the pool of private capital being used productively in Canada. One cannot be aware of the socially productive functions performed by capital in the private sector and be unconcerned about the adverse effects of these cumulative changes.

Given the extremely high rate of growth of the Canadian labour force, and the fact that, on average, each new job created requires approximately $45,000 of investment, the unfortunate consequences of any insufficiency in the supply of savings and capital are readily apparent. There can be little doubt that the adverse effects of the White Paper proposals upon the availability of savings in Canada will be substantially reflected in a reduced capacity to provide employment to any additions to the labour force and—as a consequence of a lower rate of investment—in reduced productivity.

Any shortage of savings is also likely to be reflected in higher interest rates, the major impact of which will fall upon the already vulnerable housing sector of the economy. We submit that these are consequences which few Canadians will consider desirable.

In addition to impinging upon private savings with particular severity, a policy of substituting public for private savings and investment would appear to be implicit in the White Paper. At a time when the Economic Council of Canada is predicting that existing programmes will cause the share of Gross National Product accounted for by the public sector to rise from the existing level of approximately 33% to some 37% by the mid-seventies, it is necessary to view with alarm tax-structure changes which might prompt even greater expansions. It is our view that policies which would have this effect, or which would substitute public for private saving and investment, are ones for which a mandate should be obtained.

Regional Development We are concerned by the cavalier way in which the White Paper suggests that any adverse effects upon investment may be offset by resort to appropriate monetary and fiscal policies. This may well be true, but we would suggest that it would be difficult to design monetary and fiscal policies which could be used sufficiently selectively to generate the pattern of regional expansion and development which has been a by-product of the admittedly favourable treatment received by the

extractive industries under the present tax structure. In addition to attracting substantial quantities of capital to Canada, these extractive industries have made an enormous contribution to opening up previously undeveloped sections of Canada. It is not at all clear that they will continue to do so under the White Paper proposals, nor is it made clear in the White Paper that satisfactory alternatives are available for accomplishing these same ends.

Human Motivation Human motivation also receives scant attention in the White Paper. Seemingly on the premise that all taxes contain negative consequences for the incentives to work and produce, the authors of the White Paper appear to be relatively unconcerned about the possible adverse effects of their own proposals in these areas. In particular, they do not appear to have recognized the importance of risk-taking in a growing society. Entrepreneurs can only be expected to assume risks if the rewards for doing so are commensurately high and if they have an attractive economic climate in which to operate. It is generally acknowledged that Canada lacks entrepreneurial skills and capital at the present time. We note with dismay that there is nothing in the White Paper which would improve this situation.

CONCLUSION

We feel it necessary to reiterate that a continued and vigorous expansion of the Canadian economy is prerequisite for the achievement of virtually all other economic and social goals. The achievement of a more equal distribution of income is a rather hollow victory if the income which is divided is far smaller than it could have been. We would hope that sight would not be lost of this fact when the legislation incorporating the reformed structure is drafted.

APPENDIX "A"

SHARE DISTRIBUTION OF SOME COMPANIES RECENTLY LISTED ON THE TORONTO STOCK EXCHANGE

The table below, prepared from the listing statements and prospecti on randomly selected listed Companies, reflects the ownership of substantial control blocks of shares. All companies were listed during 1969, were Canadian incorporated, and had no appreciable foreign ownership at the time of listing.

"Other restraint" implies agreements between main shareholders and the underwriter not to sell any stock involved in the offering without the underwriters' approval. "Principal Stockholder" implies ownership of 10% or more of the issued capital.

Where the principal shareholders are also directors or senior employees, no figures are shown under the column for Principal Stockholders. The figure is included in the column for directors and senior employees.

Where, however, the principal holders include others in addition to directors and senior employees, percentages are shown in both columns with no duplication in the percentages.

SHARE DISTRIBUTION OF SOME COMPANIES RECENTLY LISTED ON THE TORONTO STOCK EXCHANGE

Company	Class of shares listed	When listed: Total number of shares listed (Millions)	When listed: Total shares outstanding (Millions)	Are there listed shares under escrow or other form of restraint?	Are there other classes of shares not listed?	Percentage of listed shares held by Directors and Officers	Percentage of listed shares held by Principal Stockholders	Origin of shares held by Public (over a 6 month period prior to the time of the company's listing): Date of going public	Primary	Primary-secondary	Already held by public
Abel-Black Corporation Ltd.	Common	1.835	1.750	yes	no	80		July 4, 1969	√		
Acres Ltd.	Common	1.187	1.130	yes	no	34.32		Dec. 30, 1968	√	√	
Agratec Industries Ltd.	Common	0.789	0.789	yes	no	52.3		August 1, 1966	√		
Automotive Hardware Ltd.	Common	1.155	0.300	no	yes	(5)	(5)	April 28, 1969	√	√	
Avoca Mines Canada Ltd.	Common	5.000	4.750	yes	no	(1)	45 (2)	Nov. 4, 1969	√		√ (3)
Bombardier Ltd.	Class "A"	15.000	2.000	no	yes		86⅔	March 27, 1969		√	
Cadillac Development Corporation Ltd.	Preference Common	0.120 10.735	0.120 9.092	yes	yes	52.22	14.58	Nov. 21, 1969	√		√ (4)
Campeau Corporation Ltd.	Common	7.089	6.394	no	no	41.2	12.4	April 29, 1968	√	√	
Computel Systems Ltd.	Common	0.729	0.581	yes	no	23.7		Nov. 27, 1967	√		
Consumers Distributing Company Ltd.	Common	0.675	0.675	yes	no	24.4	55.55	Nov. 27, 1968	√	√	√
Richard Costain (Canada) Ltd.	Common	1.380	1.330	yes	no	8.08	49.81	Dec. 28, 1968	√		√
Finning Tractor & Equipment Co. Ltd.	Common	2.041	1.944	no	no		78.4	Oct. 23, 1969	√		
Four Seasons Hotels Ltd.	Common	1.377	1.250	yes	no	30.1	49.9	March 27, 1969	√		
Glendale Mobile Homes Ltd.	Common	1.145	1.075	yes	no	(6)	65.1	July 30, 1954	√	√	(7)
Harlequin Enterprises Ltd.	Common	1.328	1.328	yes	no	41.83	19.24	March 24, 1969	√	√	
Hunter Douglas Ltd.	Common	6.005 (8)	0.874	no	yes		(8)	June 11, 1969	√	√	
Irwin Toy Ltd.	Common	1.260	1.200	no	no	41.96	33.04	March 26, 1969		√	
Leon's Furniture Ltd.	Common	1.217	1.167	yes	no	72.73		June 19, 1969	√		
Voyager Petroleums Ltd.	Common	7.000	3.086	yes	no	60.14		May 27, 1969	√		
Y. & R. Properties Ltd.	Common	2.069	1.964	no	no	12.7	61.9	July 29, 1969	√		
Allarco Developments Ltd.	Common	1.675	1.250	yes	no	80		Jan. 13, 1969	√		
Commonwealth Holiday Inns of Canada	Common	6.350	2.400	no	yes	42.37	31.25	May 21, 1968	√		
E-L Financial Corporation Ltd.	Common	1.765	0.995	no	yes (9)	3.1 (10)	49.22	Nov. 13, 1968	√ (11)		
D. H. Howden & Co. Ltd.	Common	0.500	0.500	yes	yes	(9)	50 (12)	June 1, 1962		√	
Laidlaw Motorways Ltd.	Common	0.775	0.725	yes	no	72.4 (13)		April 25, 1969	√	√	
Logistec Corporation	Common	0.518	0.336	no	yes	32.1	13.7	April 3, 1969	√		
Noble Mines & Oils Ltd.	Common	4.000	1.067	yes	no	32.3 (14)	22.9 (15)	March 18, 1968			√

APPENDIX "A" continued

Company	Class of shares listed	When listed: Total number of shares listed (Millions)	When listed: Total shares outstanding (Millions)	Are there listed shares under escrow or other form of restraint?	Are there other classes of shares not listed?	Percentage of listed shares held by Directors and Officers	Percentage of listed shares held by Principal Stockholders	Origin of shares held by Public (over a 6 month period prior to the time of the company's listing): Date of going public	Primary	Primary-secondary	Already held by public
Nu-West Homes Ltd.	Common	1.750	1.650	yes	no	72		April 24, 1969	√		
Orlando Realty Corporation Ltd.	Common	1.350	1.300	no	no	58.8	10.4	April 1, 1969	√	√	
Pure Silver Mines Ltd.	Common	5.000	2.429	yes	no	20.0 (16)	22.0 (16)	April 29, 1966			√
Scott's Restaurants Company Ltd.	Common	4.158	4.078	no	no	2.5	75.36	May 21, 1968	√		
Westburne International Industries Ltd.	Common	4.429	4.034	no	yes	44.8	21.6	March 20, 1969	√ (17)		
Winnipeg Supply & Fuel Co. Ltd.	Common	0.500	0.500	no	yes	10.0	42.0	June 22, 1961			√
Realty Capital Corp. Ltd.	Class "A"	0.723	0.295	no	yes	8.06		June 25, 1969	√		√
Imperial General Properties Ltd.	Common	1.500	1.250	yes	yes	36.43	35.17	Nov. 1, 1968	√		
Gesco Distributing Ltd.	Common	1.025	1.025	yes	no	77.5		Sept. 30, 1968	√		
Halifax Developments	Common	2.886	1.875	no	no	47.44		August 19, 1965	√		√
Intermetco Limited	Common	1.634	1.408	no	no	19.96	20.15	Nov. 1, 1968	√		
J. Harris & Sons Ltd.	Common	0.913	0.846	yes	no	32.49	33.07	May 20, 1953			√
Monarch Life Assurance Co.	Common	0.550	0.500	yes	yes	57.9		(18)			√
Ensign Oils Ltd.	Common	2.100	1.450	no	no	47.17	13.79	June 19, 1968			√
U.A.P. Inc.	Class A	0.468	0.463	no	yes	11.09	50.71	Feb., 1966			√
Ulster Petroleums Ltd.	Common	4.500	3.053	yes	no	16.72		Sept. 17, 1968	√		
Western Electronics & Engineering Ltd.	Common	2.670	2.570	yes	no	18.33	51.74 (20)	June 13, 1969	√		
Lacanex Mining Co. Ltd.	Common	5.000	1.700	yes	no	20.59	38.86	April 22, 1969	√		
Murritt Business Machines Ltd.	Common	1.419	1.306	yes	yes	75.29	(19)	March 6, 1969	√		
Major Holdings & Developments Ltd.	Common	2.497	1.719	no	yes	79.1		Oct. 22, 1968	√		
Villacentres Ltd.	Common	1.040	1.002 (21)	yes	no	76.56		March 12, 1969	√		
Victoria Wood Development Corporation Ltd.	Ser. A Pr.	0.400	0.400								
	Common	1.000	0.709	yes	yes	9.81 (22)	50.00	Oct. 21, 1968	√		
Beaver Engineering Ltd.	Common	0.630	0.601	yes	no	64⅔		Sept. 2, 1969	√	√	
Prado Explorations Ltd.	Common	3.000	1.850	yes	no	16.15	42.89	June 27, 1967			√
House of Stein Electronics Ltd.	Common	0.856	0.815	yes	no	65.66		May 26, 1969	√		

(1) Less than 10%.
(2) Discovery Mines was the only principal stockholder at the time of the offering but subsequent to listing an additional 34% was acquired by 5 other Companies.
(3) Held by subsidiary.
(4) Issued with preference and debentures as Unit.
(5) One officer held 600,000 Class "B" shares and 200,000 common shares which represented 66⅔ percent of the voting shares of the Company. After conversion of series A Debentures his control would be reduced to 54%.
(6) One officer had control through the ownership of 50% of Thorn Investments Limited, which held 65.1% of Glendale.
(7) Prior to the offering in May, 1969, Thorn Investments owned all the issued shares of Glendale.
(8) A total of 4.872 million shares were reserved for conversion of deferred shares held by principal shareholders of Hunter Douglas.
(9) None issued at time of listing.
(10) The directors have substantial holdings in the subsidiary Companies.
(11) From November 27, 1968 to January 21, 1969, E-L Financial acquired 83.78% of the outstanding capital of Empire Life Insurance in a share exchange offer.
(12) Howden Holdings Ltd., as principal shareholder, owned 50% of D. H. Howden.
(13) All held by one principal officer.
(14) Held, directly and indirectly, by one officer.
(15) Percentage of shares held by 3 largest shareholders excludes shares in trust for the children of the officers.
(16) The percentages represent the holdings of the five largest shareholders, at the time of listing. Three of the five were directors. The holdings of other officers were not specified.
(17) Share exchange offers.
(18) Listed on V.S.E. some time prior to January 1, 1936.
(19) No principal shareholders but majority shareholders held 13.34%.
(20) A Director as voting trustee controlled 420,000 of the shares included in this figure.
(21) At time of listing.
(22) If the junior preference shares (all held by Directors) are converted the percentage of common shares held by them will become 35.99%.

APPENDIX "B"

140 LARGE CANADIAN PRIVATE COMPANIES, BY INDUSTRY AND BY EXTENT OF FOREIGN INTEREST AT THE END OF 1965

Source: *"The Supply Of, And Demand For, Canadian Equities".* York Study

The York Study made an estimate of the potential supply of equities which would result if a group of the larger private corporations in Canada were to make their shares available to the public. It was estimated that the total market value as at the end of 1967 of 140 large companies (excluding the larger security dealers and family investment companies) was approximately $12 billion. Although there are many other private Canadian corporations, this figure represents the market value of substantially all of the private non-financial corporations with assets in excess of $25 million. Almost 80% of these private companies were controlled by non-residents.

The $12 billion figure, if compared with the market value of outstanding Canadian listed equities at the end of 1967, suggests that the apparent supply of listed Canadian equities could be enlarged by almost a third if all the major private companies went public.

The following is a list of the names of the 140 private companies:

Mining and Other Quarrying

99.9–100.0% Foreign Interest	Canadian Johns-Manville
	Québec Cartier Mining
	Québec Iron & Titanium
	Bell Asbestos Mines
90.0–99.8% Foreign Interest	Wabush Pellett
75.0–89.9% Foreign Interest	Iron Ore

Oil and Natural Gas

99.9–100.0% Foreign Interest	California Standard
	Amerada Petroleum
	Mobil Oil
	Pan American Petroleum
	Texaco Exploration
	Sun Oil
	Tenneco Oil
	Canada Cities Service Petroleum

Foods and Beverages

99.9–100.0% Foreign Interest	Campbell Soup
	H. J. Heinz
	Kraft Foods
	Standard Brands
	Swift
	Borden
	Coca Cola
	General Foods
	Kellogg
	Canadian Schenley Distilleries
	Christie Brown
	Robin Hood Flour Mills
0.2– 49.9% Foreign Interest	St. Lawrence Sugar Refineries

Leather, Textile, Knitting and Clothing

99.9–100.0% Foreign Interest	Courtaulds
50.0– 74.9% Foreign Interest	Millhaven Fibres

Electrical Producing

99.9–100.0% Foreign Interest	R.C.A. Victor
	Sylvania Electric
	Philips Electronics Industries

Wood

99.9–100.0% Foreign Interest	Rayonier
90.0– 99.8% Foreign Interest	Fiberglass
0.2– 49.9% Foreign Interest	Canadian Forest Products

Pulp and Paper Mills

99.9–100.0% Foreign Interest	Canadian International Paper
	Ontario Minnesota Pulp & Paper
	Ontario Paper
	Kimberly Clark
	St. Regis Paper
	Spruce Falls Power & Paper
	K.V.P.
	Bowater Nfld. Pulp & Paper Mills
	Nova Scotia Pulp
50.0– 74.9% Foreign Interest	North Western Pulp & Paper
0.2– 49.9% Foreign Interest	Irving Pulp & Paper
0.0– 0.1% Foreign Interest	Minas Basin Pulp & Paper

Iron and Steel Mills

99.9–100.0% Foreign Interest	Ethyl

Machinery and Metal Fabricating

99.9–100.0% Foreign Interest	American Can
	Continental Can
	Honeywell Controls
	Cockshutt Farm Equipment
	International Harvester
	I. B. M.
	National Cash Register
	Mannesmann International
0.0– 0.1% Foreign Interest	Procor

Petroleum Refineries

99.9–100.0% Foreign Interest	British Petroleum
	Standard Oil of B.C.
50.0– 74.9% Foreign Interest	Irving Refining

Chemical and Chemical Production

99.9–100.0% Foreign Interest	Lever Brothers
	Procter & Gamble
	Société L'Air Liquide
	Dow Chemical
	Hooker Chemicals
	Monsanto
	Electric Reduction
	International Minerals & Chemicals
	Canadian Titanium Pigment
	Carol Pellet
	Allied Chemical
90.0– 99.8% Foreign Interest	Northwest Nitro
75.0– 89.9% Foreign Interest	Canadian Safety Fuse
	Shawinigan Chemical
50.0– 74.9% Foreign Interest	Gaspesia Pulp & Paper

Other Manufacturing

99.9–100.0% Foreign Interest	American Motors
	Chrysler
	General Motors
	John Deere
	Dunlop
	Firestone Tire & Rubber
	B.F. Goodrich
	Canadian Pittsburg Industries
	Duplate
	Minnesota Mining & Manufacturing
	Canadian Gypsum
	Canadian Kodak
	Anaconda American Brass
	Dominion Rubber
	Crane
	Brunswick
90.0– 99.8% Foreign Interest	Canadair
75.0– 89.9% Foreign Interest	United Aircraft

APPENDIX "B" continued

Other Manufacturing Continued

0.2– 49.9% Foreign Interest
- Allpak Products
- St. Mary's Cement

0.0– .1% Foreign Interest
- F.P. Publications
- Marine Industries
- McDonald Tobacco
- Montreal Star

Construction

99.9–100.0% Foreign Interest
- Robert A. Macalpine

0.0– .1% Foreign Interest
- Burns & Dutton Construction
- E.G.M. Cape

Electric Power

99.9–100.0% Foreign Interest
- Bowater Power

90.0– 99.8% Foreign Interest
- Manicouagan Power

50.0– 74.9% Foreign Interest
- Twin Falls Power

50% or more Foreign Interest (Canadian Control)
- Saguenay Power

Railways

75.0– 89.9% Foreign Interest
- Canadian General Transit

Other Utilities

99.9–100.0% Foreign Interest
- South Saskatchewan Pipe Line

75.0– 89.9% Foreign Interest
- Montreal Pipeline
- Trans Northern Pipeline
- National Grain

50.0– 74.9% Foreign Interest
- Peace River Oil Pipe Line
- Upper Lakes Shipping

0.2– 49.9% Foreign Interest
- Federated Pipe Lines
- Searle Grain

0.0– 0.1% Foreign Interest
- Pioneer Grain
- N.M. Paterson & Sons

Wholesale Trade

99.9–100.0% Foreign Interest
- Cyanamid
- Cargill Grain

0.1– 49.9% Foreign Interest (Foreign Control)
- Irving Oil

0.2– 49.9% Foreign Interest
- Kruger Pulp & Paper

Retail Trade

99.9–100.0% Foreign Interest
- Great Atlantic & Pacific Tea
- Gamble McLeod
- Great Universal Stores
- S.S. Kresge
- F.W. Woolworth

0.0– 0.1% Foreign Interest
- T. Eaton

Services

99.9–100.0% Foreign Interest
- Sheraton
- Wingate Equipment

Finance

99.9–100.0% Foreign Interest
- Pacific Finance
- Shellwestern Holdings
- Beneficial Finance
- Commercial Credit International
- Household Securities
- Canadian Acceptance
- Associates Acceptance
- Imperial Chemical Industries

75.0– 89.9% Foreign Interest
- Trizec

50.0– 74.9% Foreign Interest
- United Dominions

0.0– 0.1% Foreign Interest
- Cemp Investments
- Saskatchewan Wheat Pool

NOTE: Foreign interest refers to the proportion of the companies' profits that are attributable, directly and indirectly, to non-residents at the end of 1965. In virtually all cases where the percentage is 50% or greater the company is controlled by non-residents, while in most cases where the proportion is less than 50% it is controlled by residents. The two exceptions noted reflect arbitrary judgment as to the location of the control.

APPENDIX "C"

Source: *"The Supply Of, And Demand For, Canadian Equities".* York Study

CONCENTRATION OF INVESTMENTS

The major Canadian financial institutions are, in the aggregate, relatively conservative investors—generally concentrating their investments in the larger corporations. This concentration is most pronounced for the pension funds and the life insurance companies. Thus, while the 101 largest listed Canadian companies represent 77% of the total market value of all publicly traded equities at the end of 1966, the life insurance companies had 87% of their Canadian stock portfolio in these companies, and the pension funds 93%. The mutual funds concentration, however, at 79%, was almost the same as the 77% which the 101 largest listed companies represent of the total Canadian market.

While 29 companies accounted for half of the market value of all publicly traded Canadian equities, it required only 16 companies for the pension funds, 17 companies for the life insurance companies and 22 companies for the mutual funds to make up half of their Canadian equity portfolio.

Holdings in Individual Companies

Although the equity holdings at the end of 1965 of the major Canadian financial institutions in each of the 101 largest listed Canadian companies averaged 8.3% of the outstanding shares of these companies, in 12 of the companies their holdings exceeded 20% and in an additional 23 companies they held between 10% and 20% of the outstanding common shares. These 35 companies break down by industries as follows: 9 utilities (including pipelines), 10 manufacturing (including steel and food processing), 6 financial (primarily banks), 4 retail, 5 wood and paper and one mining company. Only 7 of the 35 companies rank in the largest 20 companies in terms of market value.

In dollar terms, the 10 largest Canadian company share investments of each of the major financial institutions at the end of 1966 are shown below.

ESTIMATED MARKET VALUE OF THE 10 LARGEST CANADIAN EQUITY HOLDINGS OF EACH OF THE MAJOR CANADIAN FINANCIAL INSTITUTIONS, 1966

(in millions of dollars)

	Pension Funds	Mutual Funds	Life Insurance Companies
Alcan Aluminium	35	36	14
Bank of Montreal	...	...	14
Bell Telephone	34	26	18
Canadian Imperial Bank of Commerce	...	...	18
Canadian Pacific Railway	34	28	...
Consumers' Gas	...	27	...
Dominion Foundries and Steel	36	...	...
Imperial Oil	37	38	19
International Nickel	62	50	28
MacMillan Bloedel	...	24	...
Moore Corporation	80	33	24
Noranda Mines	37	28	
Royal Bank	...	...	19
Steel Company	34	25	21
Toronto-Dominion Bank	...	...	14
Union Gas	32	...	
Totals	421	314	188
% of 10 largest holdings to all Canadian common stocks held by each institution	33	21	31

APPENDIX "D"

UNLISTED OWNERSHIP STOCKS

The following are corporations which have shares listed on The Toronto Stock Exchange but control of each company rests in a class of stock which is not listed on The Toronto Stock Exchange. The list omits such companies as Howard Smith Paper Mills Limited which is a wholly-owned subsidiary of Domtar, a listed company on The Toronto Stock Exchange.

Issue	Listed on the Toronto Stock Exchange		Not listed on the Toronto Stock Exchange
1. A. G. F. Mgmt. Ltd.	B. pr.	1,854,273	2,400 common outstanding—closely held
2. Bowaters Mersey Paper Co. Ltd.	5½% pr.	94,873	3,000,000 common—51% of common held by Bowater Canadian Corp. Ltd., 49% by Washington Post
3. Brooke Bond Foods Limited	pr.	27,016	1,000,000 common—all common shares held by Brooke Bond Liebig Limited
4. Debhold (Can.), Ltd.	B. pr.	100,000	516,375 common—De Beers Consolidated Mines Ltd.—subsidiary companies hold all common shares
5. Hahn Brass Ltd.	5% pr.	10,800	115,980 common—majority of common shares held by Amerock
6. Hendershot Paper Prod. Ltd.	6% pr.	70,000	156,075 common—100% owned by Canadian International Paper Company
7. Niagara Structural Steel Company	6½% A	18,250	475,007 common—majority of common held by H. P. Tomarin
8. Reid Lithographing Company Limited	pr.	14,665	149,621 common—majority of shares held by Rendellhall Investments Limited
9. Reynolds Aluminum Co. of Can. Limited	4¾% pr.	15,000	350,000 common—60% held by Reynolds Metals Company
10. Scott Misener Steamships Limited	5½% 1st pr.	141,838	750,000 common—Owned by Scott Misener Enterprises
11. Shell Investments	1st pr.	1,543,030	100% common—held by Shell Petroleum —the Hague
12. Becker Milk Company Limited	B. pr.	1,177,510	all outstanding common held by Euclid Securities and the Lowe family
13. Steinberg's Ltd.	Cl. A common A pr.	3,773,801 43,488	All subordinate common and preferred shares held by Steinberg family
14. Oshawa Wholesale	Cl. A	6,959,684	371,376 common—closely held

APPENDIX "E"

The following list segregates companies in identical industries according to whether they are publicly held companies or non-public (non-public includes wholly-owned subsidiaries of non-resident companies.)

PUBLIC CANADIAN COMPANIES	PRIVATE COMPANIES
AIRLINES	
Pacific Western Airlines Ltd.	Canadair Ltd.
AUTOMOTIVE	
Ford Motor Company of Canada Ltd.	General Motors of Canada Ltd.
BASE METAL PRODUCER	
Cassair Asbestos	Cdn. Johns-Manville Co. Ltd.
CHEMICALS	
Dupont of Canada Ltd.	Monsanto Canada Ltd.
ELECTRICAL PRODUCING	
Electrohome Ltd.	R. C. A. Victor
FOODS & BEVERAGES	
Silverwood Dairies Ltd.	Borden Co. Ltd.
Burns Foods Ltd.	Swift Canadian Co. Ltd.
Crush International Ltd.	Coca-Cola Ltd.
Distillers Corporation-Seagrams Ltd.	Canadian Schenley Distilleries Corp. Ltd.
George Weston Ltd.	Christie, Brown & Company Ltd.
Maple Leaf Mills Ltd.	Robin Hood Flour Mills, Ltd.
Grissol Foods Ltd.	General Foods Ltd.
Canada Packers Ltd.	
HEAVY INDUSTRY	
Finning Tractor	Cockshutt Farm Equipment of Canada Ltd.
Massey-Ferguson Ltd.	John Deere
LUMBER	
Beaver Lumber Co. Ltd.	Cashway Lumber Co. Ltd.
MERCHANDISING	
Canadian Tire Corp. Ltd.	Firestone Tire & Rubber Co. of Canada Ltd.
OIL EXPLORATION	
Aquitaine Co. of Canada Ltd.	Texaco Exploration

PUBLIC CANADIAN COMPANIES	PRIVATE COMPANIES
OIL REFINING	
Imperial Oil Ltd.	Sun Oil Company
Gulf Oil Canada	Irving Refining Ltd.
PIPE LINE	
Trans-Mountain Oil Pipe-Line Co.	Peace River Oil Pipe Co. Ltd.
PRINTING & PUBLISHING	
Toronto Star Ltd.	Montreal Star
Thomson Newspaper Ltd.	The Globe & Mail Ltd.
PULP & PAPER	
Abitibi Paper Co. Ltd.	Canadian International Paper Company
Maclaren Power & Paper Co.	Spruce Falls Power & Paper Co. Ltd.
RAILWAYS	
Algoma Central Railway	Canadian General Transit Company Ltd.
RETAIL TRADE	
Simpson's Ltd.	T. Eaton Co. Ltd.
Sayvette Ltd.	S. S. Kresge Co. Ltd.
Dominion Stores Ltd.	Great Atlantic & Pacific Tea Co. Ltd.
STEEL	
The Steel Company of Canada Ltd.	Iron Ore Company of Canada
TEXTILES	
Dominion Textile Co. Ltd.	Courtaulds (Canada) Ltd.
TRUST & LOAN	
Laurentide Financial Corp. Ltd.	Canadian Acceptance Corp. Ltd.
Union Acceptance Corp. Ltd.	United Dominions Corp. (Canada) Ltd.
MISCELLANEOUS	
Abel-Black Corp. Ltd.	Canadian Kodak Co. Ltd.

APPENDIX "F"

The table below comprises listings on The Toronto Stock Exchange in which during the year 1969 there was very limited trading. This list is not exhaustive, does not include non-resident Companies, and is limited to common shares. The definition of "limited trading" is annual trading of 3,000 shares or less.

Company	Class of Shares	Total 1969 Shares Traded
Agnew Surpass Shoe Stores Ltd.	Common	500
Ash Temple Ltd.	Common	30
Biltmore Hats Ltd.	Common	1,800
Bright, T. G. & Company Ltd.	Common	2,200
Burrard Dry Dock Co. Ltd.	Common	300
Canada Machinery Corporation Ltd.	Common	200
Canadian General Electric Co. Ltd.	Common	2,700
Canadian General Securities Ltd.	Class "B"	600
Cantrend Industries Ltd.	Class "A"	1,700
Cantrend Industries Ltd.	Class "B"	2,100
CHUM Ltd.	Common	300
CHUM Ltd.	Class "B"	1,600
Cimco Ltd.	Common	1,400
Cimco Ltd.	Class "A"	1,900
Cochrane-Dunlop Hardware Ltd.	Common	1,400
Cochrane-Dunlop Hardware Ltd.	Class "A"	1,100
Collingwood Terminals Ltd.	Common	200
Copp Clark Ltd.	Common	700
Dominion and Anglo Investment Corp. Ltd.	Common	800
Dominion Dairies Ltd.	Common	500
Dominion Fabrics Ltd.	Common	2,300
Dover Industries Ltd.	Common	2,900
Electra Investments (Canada) Ltd.	Common	—
Fittings Ltd.	Common	2,600

Company	Class of Shares	Total 1969 Shares Traded
Hinde & Dauch Ltd.	Common	3,000
+House of Stein Electronics Ltd.	Common	3,000
International Bronze Powders Ltd.	Common	1,500
Lawson & Jones Ltd.	Class "A"	1,700
Lawson & Jones Ltd.	Class "B"	60
Mexican Light & Power Co. Ltd.	Common	2,600
Monarch Investments Ltd.	Common	2,100
+Murritt Business Machines Ltd.	Common	2,500
Oakville Wood Specialties Ltd.	Common	500
Occidental Petroleum Corporation	Common	1,000
Ogilvie Flour Mills Company Ltd. (The)	Common	400
Peoples Credit Jewellers Ltd.	Common	2,900
Premier Trust Company (The)	Common	100
Quinte Milk Products Ltd.	Common	3,000
Robinson, Little & Co. Ltd.	Common	2,800
Robinson, Little & Co. Ltd.	Class "A"	1,800
Rockower of Canada Ltd.	Common	2,000
St. Lawrence Corporation Ltd.	Common	1,200
Tip-Top Canners Ltd.	Common	—
United Corporation	Class "A"	2,600
+Western Electric & Engineering	Common	2,700
+Listed during December, 1969.		
Mines		
Chibougamau Mining & Smelting Co., Inc.	Common	—
Granby Mining Company Ltd. (The)	Common	700

APPENDIX "G"

Long-established Canadian companies whose shares have shown substantial capital appreciation and, whose dividend yields have been relatively low.

COMPANY NAME	CURRENT YIELD	PRICE OF SHARES		20-YEAR PERIOD
	March '70	March '50	March '70	Capital Appreciation 1950-70
	%	$	$	%
Canada Packers	2.63	5.70 *	21.25	272.8
Canadian Tire	.52	6.80 *	68.75	911.0
Crain, R. L.	2.10	.62½*	19.00	2.940.0
Crush International	1.33	.60 *	15.00	2,400.0
Falconbridge	1.98	4.10	176.25	4,198.8
Labatt's	2.09	3.20 *	28.75	798.4
Moore Corporation	1.61	1.60 *	37.25	2,228.1
Noranda	2.99	8.60 *	36.75	327.3
Southam	2.05	5.40 *	58.50	983.3

*Adjusted for stock splits.

APPENDIX "H"

PUBLIC ISSUES AND TAX REFORM

The purpose of this section is to illustrate the income tax costs that the shareholders of closely-held Canadian companies would ultimately have to pay within the proposed tax structure should they decide to change their companies from closely-held to widely-held; i.e. to 'go public.'

For illustrative purposes, three private companies were chosen, each of which decided during 1969 to go public. These particular companies were selected to illustrate the tax costs of becoming widely-held under the White Paper proposals for the following reasons:

1. All three had recently considered the pros and cons of going public, and had decided to go ahead with public issues under the existing tax structure;

2. The three companies provided a spectrum of situations, ranging from that where the company itself received none of the proceeds of issue, to that where the entire proceeds were received by the company; and

3. The recently issued prospecti of these companies provided all of the necessary information for the computations which had to be made.

For the analysis of the income tax cost of going public, it is recognized that there are two major parts of the proposals for tax reform which must be considered:

1. In the case of a widely-held Canadian corporation, only one-half of the corporate income tax flows through to the shareholder, for inclusion in taxable income and to be claimed as a credit. In the case of a shareholder of a closely-held Canadian corporation, the full corporate income tax would flow through and be claimed as a credit. In short, while the shareholder enjoys full integration of corporate and personal income taxes in the case of a closely-held corporation, the integration is only partial in the case of a widely-held corporation.

2. Only in the case of shares of widely-held Canadian corporations will shareholders (other than other widely-held Canadian corporations) be required to revalue their portfolio every five years and include any accrued gain or loss in taxable income for that year. This will be a forced quinquennial deemed realization upon the shareholder and, of course, there is the actual realization in those cases where the shareholders divest themselves of some of their own shares as part of the public issue.

In order to make this analysis, there were certain common assumptions which were made in each of the three cases being considered:

1. Income—In each case, the net income after taxes of the company was that of the most recent complete year presented in the prospectus of the given year. This net income was assumed to be the net income for the company for the first year immediately after the company went public. For each subsequent year, it was assumed that there would be a 10% compounded rate of growth in the net income. It has been assumed that this growth of income has been reflected in a slower rate of growth of stock prices, the gross increase of these being in the order of 50% over a five-year period. Given that the growth prospects of these companies are decidedly better than average, this rate of stock-price increase would seem to impart a significantly conservative bias to the computations. Were the gains actually larger, the impact of the proposals to tax the accrued appreciation would also be larger.

2. Values—The value given the shares of each company on valuation day has been assumed to be the value at which these shares were placed in the market for the public issue.

3. Capital gain on placement—Any capital gain realized on the placement of part of a shareholder's interest in the shares of the company has been treated as a gain realized on shares of a widely-held Canadian corporation (rather than a CHC) and consequently only one-half of such a gain is included in income. It is our understanding that this is the manner in which such gains would be treated under the tax proposals.

The calculation for the capital gain on the public issue has been determined by comparing the current market value (at the time of writing) to the original placement price which has been assumed to be the value on valuation day. In the two cases when secondary issues are made in our examples, the current market values are slightly greater than values taken on valuation day.

4. Major shareholder's proceeds on placement—Hindsight has been used in determining the value of the shares of the companies in those cases where the major shareholder has sold some of his holdings as a part of the public issue. The current market value of these shares (which is in each case slightly higher than the assumed value on valuation day) has been used to calculate the gain on sale by the major shareholder.

Conclusion

Each of the three cases analyzed shows separately the tax cost related to (1) the partial integration of corporate tax and (2) the quinquennial revaluation. In each case the additional tax dollars which would have to be paid is summarized in the schedule below.

	Income Tax Cost Associated with		
	Partial Integration of corporate tax (for first five-year period)	**Quinquennial Revaluation (at the end of five-year period)**	**Capital Gain Realized on public issue (if applicable)**
	(in thousands of dollars)		
Bombardier Limited	$12,996	$45,500	$2,000
Shepherd Casters Canada Limited	278	551	13
Finning Tractor & Equipment Company Limited	2,371	2,000	N/A

Assuming that the taxpayer does not have available funds to meet this tax liability, the tax cost also has been expressed in the equivalent number of shares that would have to be sold by the taxpayer-shareholder in order to meet the tax liability. For the five-year period analyzed, the percentage of the major or key shareholder's remaining holdings in the particular company, which went public, which would have to be sold to meet the tax liability ranges from 16.3% to 17.5%. This illustrates the damaging effect on a major shareholder's control and the disincentive for such major shareholders to initiate proceedings to cause their company to go public.

APPENDIX "H" continued

BOMBARDIER LIMITED

The only shareholder of this Company was Les Enterprises de J. Armand Bombardier Ltée. which owned outright and beneficially the 15,000,000 common shares of Bombardier Limited. In the prospectus of April 1969, the 2,000,000 Class A common shares were offered to the public after supplementary letters patent established the Class A and Class B shares. The selling shareholder retained the 13,000,000 Class B common shares each of which is convertible into a Class A share and has the same rights and privileges as the Class A shares except that before any dividends may be declared on the Class B shares at least an equal amount must have been declared for each Class A share.

SCHEDULE 1

Illustration summarizing tax cost expressed in dollars and equivalent number of shares. This tax cost is also expressed as a percentage of the investment holding after the public issue. Details of the calculations of the tax cost related to partial integration, quinquennial revaluation and the realized gain on the public issue are shown on Schedules 2 and 3.

	Tax Cost	Estimated Share Value	Equivalent Number of Shares	Per Cent of Holding Remaining After Issue (13,000,000)
Realized capital gain	$2,000,000	$20	100,000	.8%
Year 1—income tax	2,129,000	22	96,700	.7
Year 2—income tax	2,342,000	24	97,600	.7
Year 3—income tax	2,576,000	26	99,100	.8
Year 4—income tax	2,833,000	28	101,200	.8
Year 5—income tax	3,116,000	30	103,900	.8
—revaluation	45,500,000	30	1,516,600	11.7
Total				16.3%

SCHEDULE 2

Tax cost due to partial integration of corporate tax of WHC.

	Company Remains Private—100% Interest Retained, 15,000,000 Shares	Public Issue Made—86.67% Interest Retained, 13,000,000 Shares
Net income	$10,980,000	$10,980,000
Dividend paid to CHC	$10,980,000	$ 8,516,000
Plus taxable credit	10,980,000	4,258,000
Gross income of CHC	$21,960,000	$12,774,000
Corporate tax—CHC	$10,980,000	$ 6,387,000
Less creditable tax	10,980,000	4,258,000
Additional tax payable—CHC	—	$ 2,129,000
Retained by CHC and paid as dividend to individual shareholders	$10,980,000	$ 6,387,000
Plus taxable credit	10,980,000	6,387,000
Individual shareholders gross income	$21,960,000	$12,774,000
Tax at 50%	$10,980,000	$ 6,387,000
Less creditable tax	10,980,000	6,387,000
Additional tax to be paid by individual shareholders	—	—
Net amount available for individual shareholders	$10,980,000	$ 6,387,000
Summary		
Tax cost for going public due to partial integration is	$ 2,129,000	
Dividend	$ 9,516,000	
Less amount received	6,387,000	
	$ 2,129,000	

SCHEDULE 3

Tax cost due to:
Realization of Gain on public issue

Valuation Day: Value of stock is $16 per share.

Realized gain:	
Proceeds on shares sold 2,000,000 shares at $20	$ 40,000,000
Less—value on valuation day 2,000,000 shares at $16	32,000,000
	$ 8,000,000
Tax cost on ½ of gain at 50%	$ 2,000,000
Quinquennial Revaluation	
Revaluation (assuming a 50% growth over 5 years) 13,000,000 shares at $30	$390,000,000
Less—value on valuation day 13,000,000 shares at $16	208,000,000
	$182,000,000
Tax cost on ½ of gain at 50%	$ 45,500,000

APPENDIX "H" continued

SHEPHERD CASTERS CANADA LIMITED

Before the public issue of shares by the major shareholder and the company was contemplated, there were four companies and the major shareholder's interest in each may be summarized as follows:

	Interest
Canadian Company	
Shepherd Casters Canada Limited	45%
American Companies	
Shepherd Casters, Inc.	51
Shepherd Casters Limited	48
Shepherd Manufacturing, Inc.	53

Prior to the public issue, there was a corporate reorganization whereby the American companies all became wholly-owned subsidiaries of the Canadian company and it was the shares of this latter company that were offered in the public issue.

A total of 300,000 common shares were included in the public issue, an equal number being drawn from treasury and from the existing shareholders. Subsequent to the corporate reorganization, but prior to the public issue, the major shareholder held a 49.7% interest in the company (including the small interest of a holding company). After the public issue, the major shareholder retained a 38.7% interest in the company which was about 444,100 common shares.

SCHEDULE 1

Illustration summarizing tax cost expressed in dollars and equivalent number of shares. This tax cost is also expressed as a percentage of the investment holding after the public issue. Details of the calculations of the tax cost related to partial integration, quinquennial revaluation and the realized gain on the public issue are shown on Schedules 2 and 3.

	Total Cost	Estimated Share Value	Equivalent Number of Shares	Per Cent of Total Holdings (444,100)
Realized capital gain	$ 13,000	$ 8	1,625	.4%
Year 1—income tax	45,500	8¾	5,200	1.2
Year 2—income tax	50,050	9½	5,270	1.2
Year 3—income tax	55,055	10¼	5,370	1.2
Year 4—income tax	60,560	11	5,510	1.2
Year 5—income tax	66,616	12	5,550	1.2
—revaluation	551,000	12	45,920	10.3
Total				16.7%

SCHEDULE 2

Tax cost due to partial integration of corporate tax of WHC (taking into account reorganization prior to public issue).

	Company Remains Private—49.7% Interest Retained By Major Shareholder	Public Issue Made—38.7% Interest Retained By Major Shareholder
Net income	$470,000	$470,000
Dividend paid to:		
Major shareholder	$233,600	$182,000
Plus taxable credit	233,600	91,000
Gross income of shareholder	$467,200	$273,000
Tax at 50%	$233,600	$136,500
Less creditable tax	233,600	91,000
Additional tax payable by major shareholder	—	$ 45,500
Net amount available for major shareholder	$233,600	$136,500

Summary

Tax cost for going public due to partial integration is	$ 45,500
Dividend	$182,000
Less amount received	136,500
	$ 45,500

SCHEDULE 3

Tax cost due to:

Realization of Gain on public issue

Valuation Day—value of stock is $7 per share.

Realized gain:

Proceeds on shares sold 52,300 shares at $8	$ 418,400
Less—value on valuation day 52,300 shares at $7	366,100
	$ 52,300
Tax cost on ½ of gain at 50%	$ 13,000

Quinquennial Revaluation

Revaluation (assuming about a 10% growth per year)

441,000* shares at $12	$5,292,000
Less—value on valuation day 441,000* shares at $7	3,087,000
	$2,205,000
Tax cost on ½ of gain at 50%	$ 551,000

*Includes small investment by a holding company.

APPENDIX "H" continued

FINNING TRACTOR & EQUIPMENT COMPANY LIMITED

There are two major shareholder interests which either directly or beneficially share equally the control of this company. The total placement made was 420,000 common shares and these shares were all issued from the company's treasury. The effect of the issue was to reduce the 100% interest of the major shareholders to 78.4%.

SCHEDULE 1

Illustration summarizing tax cost expressed in dollars and equivalent number of shares. This tax cost is also expressed as a percentage of the investment holding after the public issue. Details of the calculations of the tax cost related to partial integration and quinquennial revaluation are shown on Schedules 2 and 3.

	Tax Cost	Estimated Share Value	Equivalent Number of Shares	Per Cent of Total Holding Remaining After Issue (1,524,000)
Realized capital gain....	None	$12¾	—	—
Year 1—income tax......	$ 390,000	13	30,000	2.0%
Year 2—income tax......	429,000	14	30,600	2.0
Year 3—income tax......	471,900	15	31,500	2.1
Year 4—income tax......	519,090	17	30,500	2.0
Year 5—income tax......	570,990	18	31,700	2.1
—revaluation.....	2,000,000	18	111,100	7.3
Total.......				17.5%

SCHEDULE 3

Tax cost due to:

Realization of Gain on public issue

Valuation Day: Value of stock is $12¾ per share.

Realized gain:

None, all shares issued out of Treasury

Quinquennial Revaluation

Revaluation (assuming about a 10% growth per year)	
1,524,000 shares at $18..................	$27,432,000
Less—value on valuation day 1,524,000 shares at $12¾...........	19,431,000
	$ 8,001,000
Tax cost on ½ of gain at 50%..................	$ 2,000,000

See overleaf for Schedule 2

APPENDIX "H" continued

SCHEDULE 2

Tax cost due to partial integration for corporate tax of WHC.	COMPANY REMAINS PRIVATE 100% ownership retained		PUBLIC ISSUE IS MADE 78% ownership retained	
	91% of ownership held through a CHC	9% of ownership held as direct investment	71% of ownership held through a CHC	7% of ownership held as direct investment
Net income	$2,000,000		$2,000,000	
	91%	9%	71%	7%
Dividends paid:				
to CHC	1,820,000		1,420,000	
to individual shareholders		$ 180,000		$ 140,000
plus taxable credit	1,820,000		710,000	
Gross income CHC	$3,640,000		$2,130,000	
Corporate tax—CHC	$1,820,000		$1,065,000	
less creditable tax	1,820,000		710,000	
Additional tax payable CHC	—		$ 355,000	
Amount retained by CHC which is paid as a dividend:				
to individual shareholders	1,820,000		1,065,000	
plus taxable credit	1,820,000		1,065,000	
Direct dividend payment		180,000		140,000
plus taxable credit		180,000		70,000
Individual shareholders gross income	$3,640,000	$ 360,000	$2,130,000	$ 210,000
Tax at 50%	$1,820,000	$ 180,000	$1,065,000	$ 105,000
Less creditable tax	1,820,000	180,000	1,065,000	70,000
Additional tax to be paid by individual shareholders	—	—	—	35,000
Net amount available for individual shareholders	$1,820,000	$ 180,000	$1,065,000	$ 105,000

Summary:

Tax cost for going public due to partial integration is		$ 390,000
Reconciliation:		
Dividends paid 1	$1,420,000	
2	140,000	$1,560,000
less total amount retained by shareholder		1,170,000
Tax cost of Integration		$ 390,000

APPENDIX "I"

FEDERAL ESTATE TAXES

Canada and the United States

This Appendix, including the supporting schedules, has been developed to compare the impact of federal estate taxes on a wide range of estate values in both Canada and the United States. The Canadian estate tax legislation provides that an estate tax shall be levied on the 'aggregate taxable value' of all property passing on the death of every person **domiciled** in Canada at the time of death. The U.S. estate tax applies to the entire estate of decedents who, at the time of death, were **citizens or residents** of the United States.

The values which are compared in the supporting schedules represent the net taxable values of estates in the two countries. In this manner, any minor differences in arriving at the net taxable values of the estates have not been considered.

Comparisons of the estate tax impact on the range of estate values has been made on two bases. In one case no estate 'splitting' is contemplated while in the other, it is. Estate 'splitting' is one form of estate tax planning whereby estate taxes are reduced within the existing estate tax rate scales by exposing the total estate to tax in two parts (partly on the death of the husband and the remaining part on the death of the wide). The tax saving arising from estate 'splitting' is a result of exposing a portion of taxable estate values to tax at two points in time, at the lower marginal rates rather than exposing the estate to tax once at the higher marginal rates. The Canadian estate tax rates increase marginally to the maximum rate of 50% at a taxable estate value of $300,000. Consequently in Canada, the maximum tax saving on estate 'splitting' is $70,800 which is reached at the taxable estate value level of $600,000. In the United States, the estate tax rates also increase marginally but to a maximum of 77% on a taxable estate value of $10 million. A 50% tax rate is not applied against a taxable estate value until it exceeds $2.5 million as compared to $300,000 for Canadian purposes. Accordingly, estate 'splitting' in the United States may be effectively used to a maximum taxable estate value of $20 million compared to $600,000 for Canadian purposes. Estate 'splitting' is possible because the estate tax legislation either completely exempts from tax bequests to a widow by a husband (i.e.—Canada) or allows generous exemptions on bequests to a widow (i.e.—United States—bequest to widow exempt up to one-half of gross estate in addition to a $60,000 general exemption).

Schedule 1 compares the estate tax impact under the two conditions: (1) estate splitting, (2) no estate splitting. Schedule 2 illustrates the timing of the estate tax payments under the same two conditions. This latter recognizes the fact that for Canadian purposes if estates 'splitting' is used in the estate plan, some estate tax must be paid (except at the lower estate values) at the time of the husband's death, while without 'splitting' all tax payments are deferred until the second death (i.e., the widow). In the case of the United States, however, there is no difference in the estate tax due at the time of the husband's death if the estate plan calls for 'splitting' or if it does not. This happens because, in addition to the $60,000 personal exemption, the exempt bequest to the widow is limited to one-half of the gross estate. Consequently, there is no cost related to the 'splitting' in the U.S. such as there is in Canada where an estate is required to make tax payment on the first death because of the 'splitting'.

ESTATE TAX COMPARISONS, CANADA AND THE UNITED STATES

Summary of Assumptions

(1) Married couple with two children over 25 years of age.

(2) Two cases compared:
(i) Whole estate passes to wife and then to the two children on her death.
(ii) Estate split into two equal parts; ½ going to the wife and ½ equally to the two children.

(3) A Canadian estate (say) $100,000 would be of equal value to a U.S. estate of only $93,000. This relationship reflects the exchange differential in the purchasing power of the Canadian and U.S. dollars. It is reasonable to reflect this differential in the comparison of the estate level if converted to Canadian dollars for purposes of comparison.

Exchange rate used—
$1.00 U.S. = $1.075 Canadian.

(4) Calculation of tax and tax charge to estate:

The tax is calculated in both cases on the flow through of the whole estate to the second generation recognizing that this may be done in separate stages. There may be an estate tax liability in the United States if an estate is left in total to the widow, while there would be none in similar cases for Canadian estates. It has been assumed in such cases where there is a tax liability, that the estate tax is a charge against the widow's portion of the estate. In all other cases any estate tax liability is a charge against the bequest to the children.

(5) It is assumed that the widow maintains the capital of the estate bequested to her but does not enhance its value. Only in the case described in (4) may the capital of the estate left to the widow be reduced and that reduction would equal the estate tax charge on the bequest to the widow.

(6) These calculations ignore any estate taxes or succession duties levied by the provinces or the states and accordingly, the estate tax liabilities are shown before federal estate tax credits.

APPENDIX "I" continued

SCHEDULE 1

SUMMARY OF ESTATE TAXES ON CANADIAN AND UNITED STATES ESTATES OF EQUAL VALUE EXPRESSED IN CANADIAN DOLLARS

Value of estate in Canadian dollars	Estate Splitting — Estate split equally between widow and two children on husband's death: Canadian	Estate Splitting: United States	No Estate Splitting — Estate given outright to widow in full on husband's death: Canadian	No Estate Splitting: United States
$ 60,000	—	—	$ 3,000	—
80,000	—	—	6,600	$ 1,100
100,000	$ 3,000	—	10,800	3,800
150,000	11,400	$ 1,000	23,700	16,500
200,000	21,600	7,600	39,700	33,300
250,000	33,900	18,400	58,700	52,100
300,000	47,400	32,200	80,200	71,900
400,000	79,400	61,300	129,200	112,800
500,000	117,400	91,300	179,200	155,000
600,000	160,400	121,300	229,200	197,200
800,000	258,400	184,000	329,200	285,700
1,000,000	358,400	248,000	429,200	376,600
1,500,000	608,400	416,800	679,200	617,900
2,000,000	858,400	597,000	929,200	877,300

SUMMARY ILLUSTRATING THE TIMING OF THE TAX PAYMENTS SCHEDULE 2

Value of estate in Canadian dollars		Estate Splitting — Estate split equally between widow and two children on husband's death: Canadian	Estate Splitting: United States	No Estate Splitting — Estate given outright to widow in full on husband's death: Canadian	No Estate Splitting: United States
$ 60,000	--C	—	—	—	—
	—D	—	—	$ 3,000	—
80,000	—C	—	—	—	—
	—D	—	—	6,600	$ 1,100
100,000	—C	$ 1,500	—	—	—
	—D	1,500	—	10,800	3,800
150,000	—C	5,700	$ 500	—	500
	—D	5,700	500	23,700	16,000
200,000	—C	10,800	3,800	—	3,800
	—D	10,800	3,800	39,700	29,500
250,000	—C	16,950	9,200	—	9,200
	—D	16,950	9,200	58,700	42,900
300,000	—C	23,700	16,100	—	16,100
	—D	23,700	16,100	80,200	55,800
400,000	—C	39,700	30,650	—	30,600
	—D	39,700	30,650	129,200	82,200
500,000	—C	58,700	45,650	—	45,600
	—D	58,700	45,650	179,200	109,400
600,000	—C	80,200	60,650	—	60,600
	—D	80,200	60,650	229,200	136,600
800,000	—C	129,200	92,000	—	92,000
	—D	129,200	92,000	329,200	193,700
1,000,000	—C	179,200	124,000	—	124,000
	—D	179,200	124,000	429,200	252,600
1,500,000	—C	304,200	208,400	—	208,400
	—D	304,200	208,400	679,200	409,400
2,000,000	—C	429,200	298,500	—	298,500
	—D	429,200	298,500	929,200	578,800

NOTE: C—payable currently

D—payment deferred until death of widow

APPENDIX "J"

CAPITAL GAINS TAX

This Appendix has been developed to compare the effect, on a 'typical' investment portfolio, of a capital gains tax with five-year revaluations with the roll-over approach as proposed in Chapter 4 of this Brief. The example below shows the impact of each method of taxation on the size of portfolio and the amount of tax paid.

It is apparent from the example that the roll-over approach is more favourable to both government and investor than capital gains tax with five-year revaluations. Over a 25-year period, under the assumptions set out below, the roll-over approach would provide an additional tax yield of 19% and a final portfolio some 18% higher.

These effects would seem to indicate that the roll-over approach is indeed worth some additional administrative and compliance effort.

Example

Assume an investor, with an initial portfolio of $100,000 enjoys a constant 10% per annum rate of capital appreciation. Assume further that the investor's personal tax rate is 50% and that one-third of capital gains are taken into income. What would be the size of his portfolio and how much tax would he have paid in fifteen years and twenty-five years, given—

1. A capital gains tax with 5-year revaluations, and
2. A roll-over approach with an annual payment of 1/10th of 1% and a realization at the end of the period.

CASE 1: **A capital gains tax with 5-year revaluations:**

Value of portfolio, net of capital gains tax,	after 15 years	$343,446
	after 25 years	781,814
Capital gains tax paid	after 15 years	48,689
	after 25 years	136,350

CASE 2: **A roll-over approach with annual payment of 1/10th of 1%:**

Value of portfolio, net of final capital gains tax and annual payment,		
	after 15 years	$355,000
	after 25 years	908,766
Capital gains tax and annual payment paid		
	after 15 years	51,000
	after 25 years	161,753

The net benefits of the roll-over approach are as follows:

	1. After 15 Years	**2. After 25 Years**
(1) To investor	+$11,554	+$126,952
(2) To government	+$ 2,311	+$ 25,403

APPENDIX "B"

INDEPENDENT PETROLEUM ASSOCIATION OF CANADA

SUBMISSION ON

PROPOSALS FOR TAX REFORM

TO THE

Standing Senate Committee on Banking,
Trade and Commerce

THE SENATE OF CANADA

April 1970

INDEPENDENT PETROLEUM ASSOCIATION OF CANADA

The Independent Petroleum Association of Canada (IPAC) is a Trade Association, representing the Canadian oil and gas industry. It was incorporated under the Dominion Companies Act in 1961. It has as members 176 companies of which 131 are Canadian independent oil and gas exploration and production companies. The balance are classified as Associate Members or companies which primarily service the Canadian oil and gas industry.

IPAC represents firms which in total are responsible for over 50 per cent of all exploratory wells drilled annually in Canada. These firms derive the bulk of their revenue from reserves located in Canada and therefore must stress maximization of Canadian production.

The objectives of the Association relate generally to the establishment and maintenance of an environment under which Canadian independent oil firms can conduct their affairs in the most efficient manner possible.

This Association expressed its views on taxation in a "Submission to the Royal Commission on Taxation" in 1967, and provided a brief at that time which contained considerable detailed information on this industry. The Association welcomes the opportunity of expressing its views on the Proposals for Tax Reform as outlined in the White Paper of November 7, 1969, as we are extremely concerned with the impact these proposals could have on our industry and the Canadian economy.

SUMMARY

The Brief which follows will deal largely with the effects of the White Paper proposals as they affect the petroleum industry.

The Association endorses a number of the general views expressed in the White Paper. We agree that the tax burden should be distributed fairly; that tax policy should interfere as little as possible with incentives to work and invest; and should encourage steady economic growth and continuing prosperity.

The Association also recognizes the need for increased exemptions for lower income groups; new deductions to benefit employees and working mothers; and changes that will stimulate Canadian ownership.

The Association will offer comments which we believe will be helpful.

Our Brief is comprised of the following sections:

SUMMARY

A. THE OIL AND GAS INDUSTRY

B. PROPOSED TAX RULES FOR THE PETROLEUM INDUSTRY

C. PROPOSED TAX RULES FOR PETROLEUM INDUSTRY SHAREHOLDERS

D. PROPOSED TAX RULES FOR INDIVIDUALS

APPENDIX A

A. THE OIL AND GAS INDUSTRY

As so aptly expressed in the White Paper, we believe our industry is an "economic venture that involves exceptional risks, also promises exceptional rewards, in employing Canadians, in pushing back frontiers, in spurring trade and technology". The impact of the oil and gas industry in Canada has been profound, particularly in the following terms:

1. Moving back Canadian frontiers and bringing Canada's massive mineral resources within economic reach.

2. As an important contributor to Canadian export trade with resultant benefits to balance of payments.

3. In the establishment of a strong and viable regional economy in the West.

4. As directly and indirectly supporting over 1,000,000 people.

5. In the creation of a high demand for products manufactured in Eastern Canada.

Further, we believe that the industry is capable of a much larger job in the future, given proper incentives. We estimate that Canada has discovered approximately 11% of its oil potential and 9% of its gas potential. Demand for Canadian oil and gas should double over the next ten years. The industry can reasonably expect to increase its exports from $727 million to $2,500 million by 1980. However, to do this job requires vast sums of capital. It is estimated that the industry in Canada will need in the order of $25 to $30 billion during the next decade compared to $14 billion from 1947 to 1970. These needs will come at a time when there will be a worldwide shortage of capital. The Canadian petroleum industry has earned a rate of return on total capital in the period 1962-1968 from 6.3% to 8.8% compared to the Canadian manufacturing industry's rate of return of 8.2% to 11.1%. It can readily be seen that if the oil industry is to attract the capital required to do the job it is capable of doing, this industry must have adequate incentives.

B. PROPOSED TAX RULES FOR THE PETROLEUM INDUSTRY

Percentage Depletion – Operator and Non-Operator

One of the most important incentives for the industry is depletion. The White Paper proposal would offer less incentives than those currently available. This proposal would retroactively decrease the value of all existing oil and gas properties by changing the rules after heavy investments have been made. Insofar as future exploration is concerned, the depletion earned under the proposal is insufficient to encourage widespread exploration.

The 25% depletion for land-owners and overriding royalties would be terminated under the White Paper proposals.

WE WOULD RECOMMEND THE ADDITION OF LAND COSTS TO "ELIGIBLE EXPENDITURES" AND $1 OF DEPLETION EARNED FOR EVERY $2 OF "ELIGIBLE EXPENDITURES" INCURRED. IN ADDITION, WE SUGGEST THAT TAXPAYERS BE PERMITTED TO ELECT ANNUALLY TO CALCULATE DEPLETION UNDER EITHER ONE OF THE TWO FOLLOWING METHODS:

EITHER: 1. DEPLETION OF 15% CALCULATED ON GROSS PRODUCTION INCOME AFTER ROYALTIES BUT BEFORE ANY OTHER DEDUCTIONS NOT TO EXCEED 50% OF "NET PRODUCTION INCOME".

OR: 2. "EARNED DEPLETION" NOT TO EXCEED 50% OF PRODUCTION INCOME AFTER DEDUCTION OF ROYALTIES, OPERATING COSTS AND EXPLORATION AND DEVELOPMENT EXPENDITURES.

WE SUGGEST THAT INCOME FROM PRESENT ROYALTIES BE ALLOWED THE 25% DEPLETION, AND INCOME FROM ROYALTIES ACQUIRED AFTER IMPLEMENTATION BE TREATED AS INCOME FROM MINERAL RIGHTS GENERALLY.

Our proposals will encourage exploration and mitigate the retroactive aspect in respect to prior investments.

Exploration and Development Expenditures

The White Paper has proposed that all taxpayers be given incentive to participate directly in oil and gas exploration. The White Paper's proposal is that taxpayers who fail to meet the principal business test be entitled to deduct exploration and development expenditures to the greater of their total income from mineral production or 20% of the declining balance of such costs. While the intention of this proposal is excellent, it does not adequately reflect the risks of the business and, hence, will have extremely limited application as it could take over 10 years to amortize exploration costs.

WE RECOMMEND THE PRINCIPAL "BUSINESS TEST" BE ELIMINATED,

thereby placing Canadian taxpayers in a competitive position with U.S. taxpayers in oil and gas activities and opening up an important source of financing to our industry.

Exploration Outside Canada

The Carter Commission, as contrasted to current tax rules or those proposed by the White Paper, recommended that costs of exploring outside Canada be deductible. U.S. taxpayers are generally permitted the same deductions for oil and gas operations, whether domestic or foreign. As a consequence, U.S. foreign oil and gas operations generate $1.7 billion, or 30%, of U.S. oil company revenues. In the period 1965-1966, the petroleum industry made a net contribution of $870 million to the U.S. balance of payments.

WE WOULD RECOMMEND TREATING EXPLORATION AND DEVELOPMENT EXPENDITURES OUTSIDE CANADA THE SAME AS THOSE INCURRED IN CANADA.

Miscellaneous Business Expenses

We agree that there may have been some cases of abuse in the matter of business and entertainment expenses.

WE REGARD THE WHITE PAPER PROPOSALS AS RELATED TO MISCELLANEOUS BUSINESS EXPENSES AS UNREALISTIC AND BELIEVE THAT CURRENT REGULATIONS, IF APPLIED, ARE ADEQUATE.

C. PROPOSED TAX RULES FOR PETROLEUM INDUSTRY SHAREHOLDERS

Taxation of Capital Gains – Realized and Unrealized

In view of the substantial funds required and the high risk nature of the petroleum industry, our ability to raise capital must at all times be a fundamental consideration. We view with concern any proposal which makes it more difficult to raise capital for our industry.

Since the principal attraction of Canadian independent oil and gas equities is the prospect of capital gains, we are concerned that the capital gains tax as proposed, with maximum rates from 42% to 84% during the 5-year transition period and, thereafter, with rates up to 50% for closely-held corporations, would discourage Canadians from investing in high risk securities and would place all but the very wealthy Canadians, even after the transition period, at a disadvantage with U.S. investors in purchasing Canadian oil and gas equities.

WE RECOMMEND ALL TYPES OF CAPITAL GAINS SHOULD BE TAXED AT THE SAME RATES AND SUGGEST A GRADUAL IMPLEMENTATION STARTING WITH A MAXIMUM RATE OF 5% TAX ON GAINS NET OF CAPITAL LOSSES, INCREASING OVER 5 YEARS AND PRODUCING RATES SOMEWHAT LOWER THAN THOSE IN THE U.S.; IN ANY EVENT NOT EXCEEDING A MAXIMUM RATE OF 25% IN THE FIFTH YEAR.

The proposal to tax unrealized capital gains on shares of widely-held Canadian public corporations every five years, if enacted, will make equity investments less attractive. It is beset by a myriad of practical problems for which no solution is evident, will break up Canadian control blocks, and will be regarded by the world financial community as a tax on capital. The effect will be to impair the ability of Canadian industry in general, and our industry in particular, to raise the large amounts of capital required from Canadian and foreign sources over the next decade.

IT IS OUR VIEW THAT THE PROPOSED TAX ON UNREALIZED GAINS BE REJECTED.

Taxation of Dividends

The White Paper would remove the shareholders' depletion allowance and the dividend tax credit, both of which encourage Canadians to invest in Canadian petroleum securities. In their place, integration of corporate and shareholder tax would be substituted which would create a serious investor bias against resource development. The very incentives offered to stimulate expenditures by a company, i.e., immediate deduction of exploration and development expenditures and depletion allowances, would postpone corporate tax and, thereby, adversely effect the shareholders' net dividend income. Such a proposal decreases the attractiveness of Canadian petroleum securities to Canadians.

Secondly, the creditable tax system imposes a net tax up to 33⅓% on inter-company dividends, where the paying company's exploration write-offs and depletion credits result in a postponement of taxes. Such dividends are currently untaxed. In the oil industry, subsidiaries are a common form of operation and to merge them into one entity is often impractical or undesirable.

WE WOULD RECOMMEND THAT CONSOLIDATED TAX RETURNS BE ALLOWED.

Thirdly, the integration concept and the limit of 2½ years on creditable tax eligibility would tend to force the payment of cash or stock dividends. Such stock dividends would create unwieldy capitalizations and would have undesirable effects on the market for such securities.

In view of the above considerations:

WE WOULD RECOMMEND THAT THE CREDITABLE TAX PROPOSAL BE REJECTED AND THE DIVIDEND TAX CREDIT AND DEPLETION ALLOWANCES FOR RESOURCE STOCKS AND TAX EXEMPTION OF INTER-COMPANY DIVIDENDS BE CONTINUED.

D. PROPOSED TAX RULES FOR INDIVIDUALS

Deemed Realizations, Options and Pension Plans

Inasmuch as our industry has need of numbers of highly qualified personnel, the proposals on deemed realization, pension plans and options are of serious concern.

Transfers of personnel to and from Canada are beneficial to this industry, and the country generally.

> *A TAX ON DEEMED REALIZATION WOULD DISCOURAGE SUCH MOVEMENT AND, THEREFORE, WE SUGGEST IT BE DELETED.*

Stock options have proved to be extremely effective in attracting and motivating innovators. For this reason:

> *WE SUGGEST STOCK OPTIONS, WHETHER IN WIDELY OR CLOSELY-HELD CORPORATIONS, BE SUBJECT TO OUR SUGGESTED CAPITAL GAINS TREATMENT.*

> *THE PROPOSAL THAT PENSIONS BE SUBJECT TO A WITHHOLDING TAX AT RATES PRESUMABLY TO BE DETERMINED BY THE MINISTER, DEPENDING UPON THE RECIPIENT'S CIRCUMSTANCES, SHOULD BE REJECTED.*

Personal Incentives

The Association believes that the combination of high income tax rates and high rates of capital gains taxation proposed by the White Paper will have an adverse effect on immigration to Canada, will reduce the personal initiative of Canadians, and will result in some emigration from Canada.

A. THE OIL AND GAS INDUSTRY

Natural Resource Taxation Philosophy

Inherent in Canadian Tax Philosophy, as it applies to the Canadian mineral industry, is the recognition of benefits which accrue to the national interest in establishing a strong Mineral Resource Base. Canadian mineral tax policy has reflected in the past the unique risk factor which is characteristic of Canada's mineral resource industries. The extent to which this policy has been successful is well defined in two submissions filed with the Federal Government on the occasion of the Royal Commission on Taxation.

Canada's Mineral Resource Base can be defined as this nation's stock of mineral resources located in the subsurface which, when exposed and distributed, can contribute directly to the welfare of the country. In terms of the oil industry, it is the reserves of oil and gas which are located and subsequently defined through the efforts of the exploration and producing segment of the industry.

To-date Canada's present and potential oil and gas resource base can be described as follows:

Present Oil and Gas Resource Base

Total Reserves of Oil and Gas Discovered to End of 1969

Crude Oil	14.681 billion barrels
Natural Gas Liquids	2.473 billion barrels
Natural Gas (Marketable)	70.048 trillion cubic feet

Potential Oil and Gas Resource Base

This Association believes conservative estimates of potential hydrocarbon reserves in the sedimentary basins in Canada, including offshore areas and the Arctic Islands, to be as follows:

Crude Oil*	121 billion barrels
Natural Gas	725 trillion cubic feet

*Does not include any hydrocarbon reserves associated with Alberta's Athabasca Tar Sands or other heavy oil reserves.

Based upon the above estimates, approximately 11 per cent of the oil resource potential and approximately 9 per cent of the gas resource potential has been discovered.

Justification for Increasing Resource Base

The national interest will be served in the future if Canada's Mineral Resource Base is encouraged to expand through such means as tax incentives.

There is every indication that exports of both oil and gas to U.S. markets will expand in the foreseeable future.

PROJECTED U.S. DEMAND FOR CRUDE OIL AND PETROLEUM PRODUCTS

	Thousands of Barrels Daily				
	1969	1970	1973	1978	1983
Forecast U.S. Demand for Crude & Products	14,000	14,500	16,000	18,600	21,500
Forecast U.S. Production of Crude Oil and Natural Gas Liquids*	10,900	11,200	12,400	14,200	15,800
Deficiency	3,100	3,300	3,600	4,400	5,700

*This table is predicated on crude oil production in the south 48 States peaking in 1973 at approximately 10.3 million barrels daily – and new production from the North Slope of Alaska reaching U.S. refineries commencing in 1973 at the rate of 300,000 barrels daily; 1978 at 2,200,000 barrels daily; and 1983 at 3,300,000 barrels daily.

It is quite clear that the U.S., even with the new supply from Alaska, will be forced to depend to an increasing degree on foreign supplies. Recent developments on the subject of the U.S. import policy clearly indicate a continued preference in favour of Canadian oil supplies over all other oil producing nations in the world – on the grounds that Canada offers the most secure and stable source.

Thus, growth in demand for Canadian oil can be described as follows:

DEMAND FOR CANADIAN OIL* 1969-1983

Thousands of Barrels Daily

	1969	1970	1973	1978	1983
Domestic Demand	719	788	895	1,098	1,340
Exports to U.S.	593	665	841	1,350	2,100
Total Demand	1,312	1,453	1,736	2,448	3,440

*Includes LPG production.

The Association calculates that natural gas sales will increase over the period 1969 to 1980 as follows:

FORECAST SALES OF CANADIAN NATURAL GAS
1969 - 1980

(billions of cubic feet – 14.73 p.s.i. at 60°F

	Domestic Sales*	Export Sales*	Total Sales
1969	826	670	1,496
1970	892	744	1,636
1971	963	826	1,789
1972	1,040	917	1,957
1973	1,123	1,018	2,141
1974	1,213	1,130	2,343
1975	1,310	1,254	2,564
1976	1,415	1,392	2,807
1977	1,528	1,545	3,073
1978	1,650	1,715	3,365
1979	1,782	1,904	3,686
1980	1,925	2,113	4,038

*Excluded in this Table is gas consumed as pipeline fuel and normal losses.

Canada enjoys the unique opportunity of having large potential reserves of oil and gas and a growing market demand for such products. If this nation is to realize its potential, it is essential that the oil and gas resource base be expanded by increasing rates of annual reserve additions.

The oil and gas producing industry can reasonably be expected to make the following contribution to the Canadian economy by 1980.

(a) Value of Production* – Crude Oil, Natural Gas and By-Products

1960	–	$ 492,360,000
1968	–	1,338,404,000
1980	–	3,300,000,000

*Represents value at point of production.

(b) Value of Exports* – Crude Oil, Natural Gas and By-Products

		Export Value
1960	–	$ 125,000,000
1968	–	727,000,000
1980	–	2,500,000,000

*Represents value at border crossing point.

Future Capital Requirements

The Canadian oil and gas industry is one of the most capital intensive industries in the nation. During the period 1960 - 1969, expenditures by this industry, exclusive of transmission lines, refineries and marketing facilities amounted to $9.0 billion. During the ten year period 1970-1979, it is expected that expenditures will more than double. This increase is not only the result of the greater exploration effort required to find as much oil and gas in 10 years as has been found in over 22 years if rising demands are to be satisfied, but is also attributed to higher exploration and development costs as the industry moves northward into areas where towns, roads and airports must be built and where in the Arctic and sub-Arctic regions the temperatures and working conditions materially reduce efficiency.

CASH OUTLAY FOR THE EXPLORATION AND PRODUCING OPERATIONS OF THE CANADIAN OIL AND GAS INDUSTRY

	1960-1969 (Actual)	1970-1979 (Estimated)
	(Millions of Dollars)	
Exploration and Development Expenditures	$4,837	$12,000
Equipment and Installation Cost	727	1,400
Natural Gas Plants	808	2,000
Royalties	1,147	3,400
Operating Costs	936	1,800
Other	506	1,300
	$8,961	$21,900

In addition, $6-$8 billion could be required for oil and gas pipelines.

On the premise that the returns on future capital requirements must be commensurate with alternative investment opportunities to which such capital can be dedicated, it may be useful to examine the rate of return on invested capital in the Canadian oil and gas industry.
In the tables which follow, rates of return, as determined from a recent study prepared by Foster Economic Consultants of Calgary, Toronto and Washington, "Prospective Demand for Canadian Crude Oil Under Alternative Industry and Canadian/United States Government Policies (1969-1983)," are shown. This study indicates the return on equity capital during the period 1962-1968 in the Canadian oil industry has varied from 6.6 per cent to 10.5 per cent, compared to a return on equity in the manufacturing industry in Canada of 8.9 per cent to 12.8 per cent and Moody's 125 industrials in the U.S. of 11.8 per cent to 14.7 per cent. The rate of return on total invested capital during the same period 1962 to 1968 in the Canadian oil industry has varied from 6.3 per cent to 8.8 per cent compared to the rate in the Canadian manufacturing industry of 8.2 per cent to 11.1 per cent and the rate of the U.S. oil industry's return of 7.8 per cent to 13.4 per cent.

The foregoing sections have briefly described the problems and possibilities that face the Canadian oil and gas industry. It can readily be seen that if the industry is given adequate incentives to attract the necessary capital, it will make a most significant contribution to the future growth of the Canadian economy.

RATE OF RETURN ON COMMON STOCK EQUITY CAPITAL FOR GROUPS OF COMPANIES IN DIFFERENT INDUSTRIES 1962-1968

	1962	1963	1964	1965	1966	1967	1968	1962-68 Average
				(per cent)				
Canadian Industries								
Integrated petroleum companies	6.7	6.7	7.3	7.7	8.4	8.5	9.1	7.8
Oil and gas producers	6.6	8.0	10.0	10.5	9.5	10.3	10.5	9.3
Mining companies	13.3	12.7	15.8	16.0	14.6	14.3	13.9	14.4
Pulp and paper companies	13.8	13.2	12.6	11.7	11.7	9.1	7.7	12.0
Manufacturers	10.8	11.5	12.8	12.0	11.2	8.9	10.5	11.1
Gas utilities	8.6	9.3	10.1	11.5	12.4	12.4	12.3	10.9
United States Industries								
Integrated petroleum companies	10.2	11.1	11.1	11.5	11.9	12.2	12.3	11.5
Oil and gas producers	12.6	13.5	13.0	11.1	12.1	13.5	13.5	12.8
Petroleum refiners	8.6	10.6	12.4	14.6	16.8	16.6	15.6	13.6
Moody's 125 Industrials	11.8	12.7	13.8	14.7	14.1	12.7	13.5	13.3

Source: **FOSTER ECONOMIC CONSULTANTS,** Prospective Demand for Canadian Crude Oil Under Alternative Industry and Canadian-United States Government Policies 1969-1983, October 1969.

RATE OF RETURN ON TOTAL INVESTED CAPITAL FOR GROUPS OF COMPANIES IN DIFFERENT INDUSTRIES 1962-1968

	1962	1963	1964	1965	1966	1967	1968	1962-68 Average
				(per cent)				
Canadian Industries								
Integrated petroleum companies	6.3	6.4	6.9	7.4	7.9	8.1	8.7	7.4
Oil and gas producers	6.3	7.3	8.6	8.8	8.4	8.5	8.7	8.1
Mining companies	10.6	10.2	12.8	13.3	12.1	11.9	11.2	11.7
Pulp and paper companies	12.3	12.0	11.4	10.5	9.9	7.8	7.4	10.2
Manufacturers	9.5	10.1	11.1	10.5	10.0	8.2	9.7	9.9
United States Industries								
Integrated petroleum companies	9.4	10.1	10.1	10.6	10.9	10.9	11.0	10.4
Oil and gas producers	12.4	12.9	12.5	10.9	11.8	13.1	13.3	12.4
Petroleum refiners	7.8	9.1	10.3	11.9	13.4	12.8	12.2	11.1

Source: **FOSTER ECONOMIC CONSULTANTS**, Prospective Demand for Canadian Crude Oil Under Alternative Industry and Canadian-United States Government Policies 1969-1983, October 1969.

B. PROPOSED TAX RULES FOR THE PETROLEUM INDUSTRY

The White Paper, in its discussion of the proposed tax changes for the mining and the petroleum industry, noted that the exploration for and development of mines and oil and gas deposits involved more than the usual industrial risks and that the scale of these risks was quite uncertain. We submit that while the important factor of risk was noted, it was not properly reflected in the proposed changes in tax rules.

1. Exploration and Development Expenditures

The importance to the petroleum industry of the immediate deduction of exploration and development expenditures incurred in Canada and the carry forward rules relating to such expenditures has been recognized in the White Paper. It is also important to the industry, and to Canadians generally, that the same tax rules for such expenditures apply to taxpayers other than those engaged directly in our industry. Unfortunately, this would not be the case under the White Paper.

There would be restrictions for taxpayers whose principal business was not related to mining or petroleum. The restrictions would limit deductions for exploration and development expenditures incurred by those taxpayers to the greater of their total income from mineral production or 20 per cent of the declining balance of such costs. Such a limitation would materially reduce the intended incentive. Deductions for unsuccessful exploration would take over ten years to be amortized against taxable income. This would not be a sufficient incentive to encourage significant participation having in mind the risk factor involved. The proposed treatment of capital losses on shares of closely-held corporations would allow individuals to conduct their exploration activities in closely-held corporations and, thereby, deduct capital losses immediately rather than deduct exploration expenditures over a long period. The direct approach would be desirable and the use of closely-held corporations solely for tax reasons would be impractical and cumbersome for the taxpayers and inconsistent with the objectives of tax reform.

The Association, therefore, regrets that the principal business test would be continued under the White Paper. No such test should be made if we are to have a desirable degree of Canadian participation in the important search for oil and gas reserves in Canada. This restrictive tax rule would continue to place Canadians at an unwarranted disadvantage with U.S. citizens, who are not subject to such rules, when investing in exploration in Canada. United States citizens invested over one hundred million dollars ($100,000,000) directly in Canadian exploration programs in 1969. Such investments constitute an important source of capital.

THE ASSOCIATION RECOMMENDS THAT THE PRINCIPAL BUSINESS TEST BE ELIMINATED.

By so doing, the industry would be provided with a further source of capital as individual Canadians would have the opportunity of participating in the petroleum industry on a more equal basis with their U.S. counterparts.

2. Percentage Depletion – Operators

The White Paper recognizes the need for incentives in the mining and petroleum industries because of the high degree of risk and the magnitude of the investment at risk. The incentive proposed is inadequate.

The Association historically has supported the principle of gross depletion in its submissions concerning tax reform and continues to do so. Gross depletion has proved to be extremely effective for the industry in other jurisdictions and has broad investor acceptance.

Depletion encourages continuing capital investment in resource development by making possible a return that is commensurate with the risks involved. Without an adequate return, capital will look elsewhere. The yardstick that is employed in making investment judgments

takes into account both risk and tax incentives in one industry as opposed to another. Despite widespread belief to the contrary, the return on invested capital in the petroleum industry in Canada today is less than that of the manufacturing industry, as a group. The willingness of capital to continue investing in the petroleum industry is based on the long term prospects for at least a reasonable return. This willingness to continue will also depend to a large extent on the stability of tax rules relating to such investments.

The present depletion incentive represents for practical purposes a 33⅓ per cent tax rate on net production income. The White Paper would raise the tax rate on net production income to 50 per cent and provide special credits against such income based on exploratory expenditures.

The proposed White Paper depletion incentive, or so-called "earned depletion", would be related to certain exploration and development expenditures. Depletion credits would be earned at the rate of $1 for each $3 of eligible exploration and development expenditures. "Earned depletion" credits could be claimed as a deduction from net production income up to a maximum of ⅓ of such net production income after deduction of exploration and development expenditures. Any excess earned depletion would be carried forward until it could be used in this manner. This proposal would become effective after a five year transitional period. During such five year period "earned depletion" credits accrue and, to the extent not claimed against new production income, would accumulate. Depletion at 33⅓ per cent of net would be used during the five year transitional period for existing production.

The White Paper proposal, by relating incentive to future expenditures, has retroactively changed the basis on which previous investments were made. Such investments were predicated on an ultimate tax rate of 33⅓ per cent and would now be subject to a 50 per cent tax rate. It is apparent that such a change would immediately and adversely affect the value of all existing oil and gas properties in Canada and, further, it would seriously impair the image of the industry in Canada with regard to future investment plans.

The Association believes that to be most effective, the depletion incentive should be based on revenue since this rewards success in resource development and, thereby, acts as a stimulant to exploration activity. In addition, such a system of computing depletion clearly tends to encourage the best use of resources and manpower and would provide a considerable degree of flexibility in the timing of such investments. We do not believe that the "earned depletion" proposal would be nearly as effective by itself.

WE RECOMMEND THAT A MORE EFFECTIVE MEANS OF PROVIDING INCENTIVES FOR FUTURE EXPLORATION WOULD BE THROUGH AN OPTIONAL SYSTEM THAT WOULD PERMIT TAXPAYERS TO ELECT ANNUALLY TO CALCULATE DEPLETION UNDER EITHER ONE OF THE TWO FOLLOWING METHODS:

1. *DEPLETION OF 15 PER CENT CALCULATED ON GROSS PRODUCTION INCOME AFTER ROYALTIES BUT BEFORE ANY OTHER DEDUCTIONS BUT NOT TO EXCEED 50 PER CENT OF "NET PRODUCTION INCOME".*

   Net production income is defined as gross income from mineral production after deduction of royalty payments, and direct operating costs, but before any deductions for exploration and development (Section 83A) expenditures.

2. *"EARNED DEPLETION" NOT TO EXCEED 50 PER CENT OF PRODUCTION INCOME AFTER DEDUCTION OF ROYALTIES, OPERATING COSTS AND EXPLORATION AND DEVELOPMENT EXPENDITURES.*

Our proposal would encourage continuing exploration and would mitigate the retroactive aspect mentioned above with respect to prior investments.

THE ASSOCIATION PROPOSES THAT "EARNED DEPLETION" BE COMPUTED IN THE FOLLOWING MANNER:

1. *DEPLETION TO BE EARNED AT THE RATE OF $1 FOR EACH $2 OF "EXPLORATION COSTS" INCURRED.*
2. *ALL EXPLORATION AND DEVELOPMENT COSTS INCLUDING LAND ACQUISITION COSTS ("EXPLORATION COSTS") BE INCLUDED AS ELIGIBLE EXPENDITURES.*

The Association believes that such an optional system would be consistent with the objectives of both government and industry. It would provide a realistic and necessary inducement for long term investment on a scale sufficient to assure continuing exploration and adequate development of Canada's oil and gas resources.

3. Percentage Depletion – Non-Operators

The present tax rules permit "non-operators" to deduct 25 per cent of their royalty income from mineral properties as a depletion allowance. In addition to the land-owners' royalty, gross overriding royalties are created in the normal course of business in the petroleum industry. The White Paper proposals would terminate this depletion allowance for both land-owners and overriding royalty holders immediately upon implementation.

The White Paper suggests that the current depletion allowance for acquired royalties is, in part, a recognition of the return of capital and further suggests that such recognition would no longer be necessary because of the proposed rules concerning the amortization of the cost of acquiring mineral rights. This proposal would alter, in a material sense, the basis upon which present royalty owners acquired their interest.

The Association submits that the proposal should be amended to distinguish between royalties held before implementation and those acquired subsequent to implementation. Failure to make this important distinction for present royalty owners would be confiscatory.

THE ASSOCIATION RECOMMENDS THAT THE INCOME FROM ROYALTY INTERESTS ACQUIRED AFTER IMPLEMENTATION SHOULD BE TREATED IN THE SAME MANNER AS INCOME FROM MINERAL RIGHTS GENERALLY AND INCOME FROM PRESENT ROYALTIES SHOULD CONTINUE TO BE TAXED UNDER THE PRESENT RULES PROVIDED THEY ARE NOT SOLD.

4. Exploration Outside Canada

Exploration and development expenditures incurred outside Canada are, for the most part, not deductible under present tax rules and would not be deductible under the White Paper proposals. The White Paper recognizes the need for Canadian industry to seek foreign sources of supply and to develop foreign markets and states that, as a basic policy, "The proposals are designed neither to provide an incentive to Canadians to invest abroad, nor to place a barrier in the way of their doing so." The proposed tax rules for the mining and petroleum industries would not permit deductions for exploration and development incurred outside Canada, and the change from percentage depletion to earned depletion places a further barrier in the way of exploration outside Canada.

The benefits of foreign exploration were significant factors in the growth of the U.S. petroleum industry. Foreign exploration is possible under U.S. tax rules and the dominant position of U.S. companies in the world petroleum industry is the result of such foresight. According to the Chase Manhattan Bank's 1968 Annual Financial Analysis of the major U.S. oil companies, earnings from foreign operations accounted for 30 per cent of the group's total net income of

$5,739,000,000 in 1968. Crude oil production by this group of companies averaged 18.6 million barrels daily and accounted for 59 per cent of all the oil produced in the Free World with 12.3 million barrels daily being produced outside the United States. In addition, in 1965-66, the petroleum industry sent abroad an average of $885 million of funds from the United States; but against this, earnings on foreign investments over and above those reinvested abroad were some $1.8 billion, for a net *CONTRIBUTION* tothe U.S. balance of payments of $870 million. There is no question as to the importance of the petroleum industry and its foreign investments to the United States economy.

The Royal Commission on taxation recommended that "costs of exploring outside Canada be deductible." We agree with this recommendation and submit that successful resource exploration anywhere in the world would bring substantial benefits to Canada in the form of additional foreign exchange, alternate sources of supply for crude deficient areas of Canada, markets for Canadian expertise in resource development and a strengthening of the Canadian independent petroleum industry in terms of the worldwide petroleum industry.

> *THE ASSOCIATION, THEREFORE, RECOMMENDS THAT EXPLORATION AND DEVELOPMENT EXPENDITURES INCURRED OUTSIDE CANADA BE TREATED THE SAME AS THOSE EXPENDITURES MADE IN CANADA.*

5. Miscellaneous Business Expense

The White Paper proposes to disallow completely "entertainment and related expenses." We accept that there may have been cases of abuse in the name of business entertainment and we in no sense condone such practice. For instance, we do not believe private yachts and lodges and similar expenses can be justified as a deduction from taxable income. On the other hand, we do firmly believe that conventions, club memberships, etc., are necessary and legitimate business expenses and to regard such costs otherwise is to ignore the reality of business activity in Canada. In this industry, engineering, geological and geophysical developments occur world-wide and only through conventions and similar meetings can personnel in this industry stay abreast of important technical advances so that application can be made of these developments in their respective fields. The oil industry is an extremely complex and fast-moving business; constant contacts with all phases are required daily if a company is to remain competitive. Business lunches and dinners provide a neutral setting and are accepted practice at which daily developments are reviewed; contacts are made; negotiations are conducted; and various engineering and geological ideas are exchanged. All of these activities are a necessary part of business in our industry. Unquestionably, the same situation must be true in other industries.

> *THE ASSOCIATION DOES NOT CONDONE ABUSES OF THE PRESENT TAX RULES. HOWEVER, IT REGARDS THE WHITE PAPER PROPOSALS THAT WOULD DISALLOW ALL SUCH EXPENSES AS UNREALISTIC. IT BELIEVES THAT ADEQUATE TAX RULES EXIST TODAY AND THAT THE PROPOSED RULES WOULD PLACE AN UNNECESSARY ADMINISTRATIVE BURDEN ON BOTH GOVERNMENT AND INDUSTRY TO ENSURE COMPLIANCE.*

C. PROPOSED TAX RULES FOR PETROLEUM INDUSTRY SHAREHOLDERS

The White Paper proposals that relate to petroleum industry corporations and their shareholders would remove the encouragement presently given to Canadians who wish to invest in securities of Canadian petroleum corporations. The existing inducements that would be withdrawn under the new proposals are as follows:

1. 20 percent Dividend Tax Credit
2. Shareholders' depletion allowance
3. Tax free capital gains

4. Tax exemption for inter-company dividends

They are important factors in respect to investments in Canadian resource corporations.

The White Paper proposes the following:

1. Integration of Corporate and Shareholder tax (creditable tax)
2. Discontinuance of shareholders' depletion
3. Tax on capital gains
4. Discontinuance of tax exemption on inter-company dividends

Our Association is seriously concerned with the disruptive effect on the securities of resource and capital intensive companies that could result from implementation of these changes.

Under the White Paper proposals there would be two classes of corporations, that is, widely-held and closely-held. Simply stated, widely-held corporations would be those Canadian public corporations whose securities are traded in qualified markets, and closely-held corporations would be all other Canadian corporations. The tax treatment of shareholders of widely-held corporations would differ from that accorded shareholders of closely-held corporations as follows:

	Individual Shareholder In	
	Widely-Held Corporation	Closely-Held Corporation
Gross-up for corporate tax	50%	100%
Amount of capital gains on sale of shares subject to tax	50%	100%
Amount of unrealized gains subject to tax on quinquennial basis	50%	Nil

Corporate shareholders would be subject to a special tax rate of 33⅓ per cent on dividends from, and on realized or unrealized gains on shares of widely-held corporations.

The White Paper has proposed these two classes of corporations in order to segregate them into groups that compete directly with each other. We submit that such a grouping is totally invalid for corporations engaged in the petroleum industry. Under the proposed rules, subsidiaries of some of the world's largest companies operating in the Canadian petroleum industry would be classified as closely-held even though they are operating in direct competition with many smaller widely-held companies in this industry. (This is one illustration of the tendency of many of the White Paper proposals to over-simplify the existing economic facts in advancing certain of its proposals). The proposed tax treatment for dividends and capital gains is discussed under the following headings:

1. Taxation of Capital Gains – Realized
2. Taxation of Capital Gains – Unrealized
3. Taxation of Dividends

1. Taxation of Capital Gains – Realized

As previously noted, the capital requirements of the Canadian oil and gas industry during the 1970's have been estimated in the order of $25-$30 billion. A significant portion of this sum will take the form of new corporate financing and new exploration participations, particularly in the case of members of this Association whose oil and gas income has not yet reached levels sufficient to support current programs much less the higher level of exploration activity required in the future. Our industry has been unable to raise a majority of its equity and debt capital from Canadian sources in the past even with the existing depletion allowances, dividend and

depletion credits, which are more favourable than the White Paper proposals, and the absence of capital gains taxation. Any impairment of our ability to attract capital from Canadian and foreign sources would be detrimental to the economy.

The proposal to tax one-half the capital gains derived from the sale of shares of widely-held Canadian public corporations at regular income rates would result in Canadian taxpayers paying substantially higher taxes on capital gains than would be the case for U.S. investors in Canadian securities during the transition period, due principally to the difference between the marginal tax rates of the two countries. This disadvantage would continue after the transition period as Canadian taxpayers, particularly those in the middle income group, would still pay substantially higher taxes on capital gains than their U.S. counterparts, with the exception of very wealthy Canadians. We invite attention to the schedules attached as Appendix A prepared by Price Waterhouse & Co., Calgary, which illustrates the comparative position of Canadian taxpayers at various levels of income and capital gains with U.S. taxpayers in similar circumstances. The first example compares a Canadian taxpayer with a U.S. taxpayer both enjoying a salary of $10,000 and capital gains of $5,000 in the shares of widely-held public corporations. Under the proposals of the White Paper, the Canadian would pay capital gains tax at a 17.6 per cent rate, while the U.S. taxpayer, having held the securities longer than six months, would pay a capital gains tax at a 10.4 per cent rate in 1970 reducing to 8.1 per cent by 1974. Thus, with full implementation of the White Paper, such a Canadian taxpayer would be paying capital gains tax at more than twice the rate of his U.S. counterpart.

The disparity in the tax treatment between the two countries in respect to capital gains derived from the sale of shares of closely-held companies, or from direct investments, is even more pronounced. The White Paper proposes that capital gains on foreign direct investments and foreign investment in the shares of closely-held companies be taxed at Canadian ordinary income rates. This would create a strong disincentive for U.S. investment in Canada if tax treaties are revised. If tax treaties cannot be revised in this respect, Canadian investors could find themselves at an even greater disadvantage in respect to U.S. investors who hold shares of closely-held Canadian companies.

The principal attraction of Canadian independent oil and gas company equities is the prospect of capital gains. The imposition of a capital gains tax in Canada at rates substantially higher than those effective for most U.S. citizens will place Canadians at a disadvantage in making investments in Canadian oil and gas equities. There are a number of cogent arguments which may be advanced for preferential rates of tax on capital gains, rather than those rates proposed in the White Paper, among them the encouragement of investment vis-a-vis consumption, the furtherance of domestic ownership of industry, and the growth of the economy, but perhaps the most important to the Canadian situation is the recognition of the risk factors involved in equity investments in Canada. The risk factors to be considered in making equity investments in a natural resource country such as Canada, many of whose frontiers are only now opening up for economic development, are of a different order of magnitude than the risk factors which investors must consider when they invest in the equities of companies in the more mature economies. Therefore, a lower rate of tax on capital gains should pertain in Canada than in more mature economies.

We are further concerned that the proposals of the White Paper involve a five-year transition period in respect to marginal tax rates. During the first year of the transition period, the maximum capital gains tax rate in Canada will vary from 42 per cent to 84 per cent compared with a maximum rate in the United States slightly higher than 29½ per cent. The higher rates of capital gains taxation at the beginning of the transition period will act as a deterrent to new investment and could result in some lock-in problems with reduced liquidity in Canadian security markets.

The proposal to tax all forms of capital gains other than gains on the sale of shares of widely-held Canadian public corporations at regular income rates has serious consequences for our industry,

for the growth of small businesses in Canada, and the Canadian economy in general. There are a number of privately-held companies in oil and gas exploration and in service activities supporting the oil and gas industry. These companies, in contrast to the highly theoretical assumptions of the White Paper, compete primarily with publicly-held companies and not to any extent with individual proprietorships. Many of these companies have growing requirements for new financing but may not be sufficiently seasoned to offer their securities to the public marketplace. Quite frequently, a private placement with a single institutional or large private investor is the preferred method of obtaining funds. From the investor's viewpoint the rewards of such a relatively high risk investment lie in the prospect of potential capital gains. The White Paper's assumption that the investor in private companies need not be concerned whether the investment rewards come in the form of dividends carrying full tax credit for corporate taxes paid or in the form of capital gains does not relate to the investment realities of our industry. The reason should be obvious, namely, that in growth-type companies investment values are determined more on potential than on book values, earnings, and dividends. The investment philosophy pertaining to fixed-income bearing obligations cannot be applied to risk-type growth equities without prejudice to the latter type of investment and to the growth of the economy.

The Association, therefore, is seriously concerned about the future ability of its members to attract capital under the White Paper proposal for the taxation of capital gains. It believes, for an economy which has never had a capital gain tax, that the proposed tax on capital gains should be phased into the tax structure gradually rather than beginning with extremely high rates and gradually reducing them, and that capital gain tax rates should certainly be less than rates in the more mature U.S. economy.

THEREFORE, WE RECOMMEND THE FOLLOWING AS AN ALTERNATIVE TO THE WHITE PAPER PROPOSALS:

1. *ALL TYPES OF REALIZED CAPITAL GAINS SHOULD BE SUBJECT TO THE SAME RATES OF TAX.*
2. *IMPLEMENTATION OF A TAX ON REALIZED CAPITAL GAINS NET OF CAPITAL LOSSES SHOULD BEGIN AT A MAXIMUM RATE OF 5 PER CENT AND INCREASED OVER A FIVE YEAR PERIOD TO PRODUCE RATES SOMEWHAT LOWER THAN THOSE IN EFFECT IN THE UNITED STATES, NOT TO EXCEED A MAXIMUM OF 25 PER CENT.*
3. *GAINS OR LOSSES REALIZED AFTER IMPLEMENTATION SHOULD BE COMPUTED ON GREATER OF COST OR MARKET VALUE ON VALUATION DAY.*
4. *IF OUR PROPOSAL IS ADOPTED, ALL REALIZED CAPITAL LOSSES SHOULD ONLY BE DEDUCTED FROM REALIZED CAPITAL GAINS WITH A FIVE YEAR CARRY FORWARD PROVISION.*

2. Taxation of Capital Gains – Unrealized

The Association does not agree with the proposal to tax unrealized gains on shares of widely-held corporations. The proposed tax would be levied every five years on unrealized gains on investments held by Canadians and by non-residents holding at least 25 per cent of the shares of a widely-held corporation. This periodic taxation of unrealized gains would make equities in the resource industries, which are subject to extremely wide market fluctuations, far less attractive to Canadian investors. The partial sale for tax purposes of Canadian control blocks could completely change such control. The substantial capital required, combined with the disadvantage of Canadian ownership, could place control in foreign hands.

We believe the proposal, if adopted, would be regarded by all world financial communities as a tax on capital and would raise serious doubts whether Canada would be a desirable place for investment. Further, we regard the proposal as being beset with so many practical difficulties, among them tax selling pressures, marketing problems, regulatory problems, particularly with interlisted securities, and insider trading problems, that it is virtually unworkable.

Most tax jurisdictions have recognized the value of long term investment and encourage such investment. The White Paper proposal would be a discriminatory tax on Canadians and would discourage, rather than encourage, long term investment by Canadians. It conflicts with the objective of most Canadians, that is, to strengthen, not weaken, Canadian ownership of business activity in Canada. It would discourage closely-held corporations from offering public participation. Moreover, it would penalize those that have already done so. Many foreign-owned operations in Canada responded to inducements offered to them in the form of reduced withholding taxes and invited Canadian participation. The proposed tax would penalize them for conforming to past government policy. Those that did not take the desired steps for Canadian participation in their Canadian operations would be exempt from the proposed tax on unrealized gains and would undoubtedly continue to operate in Canada either as a branch operation or a closely-held corporation.

THE ASSOCIATION SUBMITS THAT SUCH A TAX WOULD BE A RETROGRADE STEP FOR CANADA AND, THEREFORE, RECOMMENDS THAT THE PROPOSED TAX ON UNREALIZED GAINS SHOULD BE REJECTED IN ITS ENTIRETY.

3. Taxation of Dividends

The creditable tax proposal would permit Canadian shareholders to obtain credit for income taxes paid by the corporation on its profits. As stated previously, corporate income taxes would be credited to the shareholder at 50 per cent of the tax paid in the case of a widely-held corporation, and at 100 per cent in the case of a closely-held corporation, assuming all earnings are distributed in cash or stock dividends.

The creditable tax proposal is put forward as a strong inducement for Canadians to invest. We believe that this inducement would create a serious investor bias against investments in faster growing, lower tax and dividend paying resource and other capital intensive industries in favour of slower growing, higher tax paying, higher dividend paying industrial corporations. To encourage the growth of these resource and capital intensive industries, tax incentives are granted in the form of accelerated capital cost allowances, immediate deduction of exploration and development expenditures, depletion allowances and claims for scientific research. Under the creditable tax proposal any postponement of corporate tax resulting from the utilization of such incentives would have an adverse effect on the shareholder's net (after tax) dividend from his investment. Such a result negates to some extent the objectives of the incentives, namely, rapid growth of the resource and capital intensive industries, to realize their potential as major contributors to the future development of the Canadian economy. The table on page 20 illustrates the bias against resource stocks as a result of the integration of corporate and shareholder tax.

The petroleum industry is seriously concerned that the investor bias, resulting from the proposed integration of corporate and shareholder tax, would decrease the industry's ability to raise capital in Canada.

Many companies in the petroleum industry conduct their operations through a group of companies. The proposed creditable tax system would impose a net tax up to 33⅓ per cent on inter-company dividends in those cases where the paying corporation had utilized incentives provided under the proposed tax rules to postpone its income taxes. In a growing high-risk industry, such as the petroleum industry, there is a constant change in Canadian or foreign companies and groupings occasioned by need for capital, strengthening management and dynamic competition. Subsidiaries become quite commonplace, created for joint ventures, created to distribute heavy risks, or acquired by merger or acquisition. Jurisdictional problems between provinces, worldwide operations, or share structures, can make consolidation into one entity often impractical or undesirable. The additional tax burden the White Paper proposes for inter-company dividends not accompanied by full creditable tax would have a serious effect on the operations of such companies and could tend to force them to reorganize their operations and to operate in a less efficient or less desirable manner solely for tax reasons.

The proposed option to treat corporations as partnerships is too restrictive for many corporate groups to use. The partnership option as proposed would relate solely to shareholders of closely-held corporations.

WE RECOMMEND THAT CONSOLIDATED TAX RETURNS BE PERMITTED FOR RELATED CORPORATIONS.

A COMPARISON OF THE EFFECT OF CREDITABLE TAX ON SHAREHOLDER IN TWO TYPES OF WIDELY-HELD CANADIAN COMPANIES

(excluding capital gains)

	Industrial Company (fully taxed)		Oil & Gas Company (Without Taxable Income)	
	Present	Proposed	Present	Proposed
Pays cash or stock dividend of	$1.00	$1.00	$1.00	$1.00
Tax treatment of shareholder with marginal tax rate of 30%				
Dividend received	$1.00	$1.00	$1.00	$1.00
Less: depletion allowance	–	–	.20	–
Plus: taxable credit	–	.50	–	–
Dividend subject to tax	$1.00	$1.50	$ .80	$1.00
Tax at 30%	$ .30	$ .45	$ .24	$ .30
Less: dividend tax credit	.20	–	.16	–
creditable tax	–	.50	–	–
Net tax payable (refund)	$ .10	($ .05)	$ .08	$ .30
Net dividend after tax	$ .90	$1.05	$ .92	$ .70
% of tax paid on gross dividend	10%	5%*	8%	30%
% change in net dividend as a result of creditable tax		+16.6%		–23.9%
*tax refund				
Tax treatment of shareholder with marginal tax rate of 50%				
Dividend received	$1.00	$1.00	$1.00	$1.00
Less: depletion allowance	–	–	.20	–
Plus: taxable credit	–	.50	–	–
Dividend subject to tax	$1.00	$1.50	$ .80	$1.00
Tax at 50%	$ .50	$ .75	$ .40	$ .50
Less: dividend tax credit	.20	–	.16	–
creditable tax	–	.50	–	–
Net tax payable	$ .30	$ .25	$ .24	$ .50
Net dividend after tax	$ .70	$ .75	$ .76	$ .50
% of tax paid on gross dividend	30%	25%	24%	50%
% change in net dividend as a result of creditable tax		+7.1%		—34.2%

The suggestions in the White Paper, combined with the 2½ year time limit on creditable tax eligibility whereby Canadian companies paying taxes should pay out substantially all their earnings, either in the form of cash or stock dividends so that shareholders realize maximum benefits, warrants serious concern for the future.

Canadian companies will certainly not wish to pay out 100 per cent of their earnings in cash, particularly in view of the existing and probable future capital shortage. Therefore, the payment

of stock dividends is the practical alternative which requires analysis. We feel it is highly undesirable for Canadian companies to be forced, for tax purposes, to pay periodic stock dividends. Presently, recipients of stock dividends often sell the shares which they receive.

This undesirable effect would be more pronounced under the proposal as many shareholders would sell to realize cash to pay taxes. This, of course, would have a depressing effect on security markets and would make corporate financing more difficult. Security analysts and the corporations themselves would periodically be required to "pro forma" past corporate earnings on the basis of present capitalizations in order to arrive at meaningful per share earnings comparisons, which is one of the reasons why the concept of paying periodic small stock dividends has never been widely accepted by the investment community. Furthermore, many investors prefer the leverage of small capitalizations, particularly in natural resource companies, where the principal investment appeal lies in capital gains in the event of significant discoveries. The prospect of unwieldy capitalizations, difficulties between classes of shareholders, shareholders of different countries, plus many other problems inherent in the proposal, occasioned by the compulsory payment of earnings as stock dividends, is not likely to appeal to our investors or investors in other securities.

THE ASSOCIATION RECOMMENDS THAT THE CREDITABLE TAX PROPOSAL BE REJECTED, AND IF ANY CHANGE IS MADE THAT THE PRESENT DIVIDEND TAX CREDIT BE INCREASED TO ENCOURAGE INVESTMENT IN RESOURCE STOCKS; THE PRESENT TAX EXEMPTION OF INTER-COMPANY DIVIDENDS BE CONTINUED AND THAT SHAREHOLDERS OF RESOURCE COMPANIES CONTINUE TO RECEIVE DEPLETION ALLOWANCES.

D. PROPOSED TAX RULES FOR INDIVIDUALS

The petroleum industry's reliance on highly trained personnel requires this Association to comment on certain of the White Paper proposals that impose additional tax burdens on individuals.

1. Marginal Tax Rates

Marginal tax rates would reach approximately 33⅓ per cent at the level of $5,000 of taxable income and would escalate to 51.2 per cent when taxable income reaches $24,000. These are such high rates of tax, especially so when combined with the proposed high rates of tax on capital gains, that employment opportunities in the industry outside of Canada, in particular for new graduates, will become more attractive to Canadian personnel. Further, there will be an adverse effect on immigration to Canada and on personal initiative of Canadians.

THE ASSOCIATION HAS RECOMMENDED TAX RATES ON CAPITAL GAINS WHICH WOULD SERVE TO ALLEVIATE THE HIGH PERSONAL INCOME TAX RATES TO SOME EXTENT.

2. Deemed Realizations

The implications of such a restriction on individual liberty are repugnant to the Canadian conscience. Aside from the aspect of personal liberties, Canadians taking temporary overseas assignments would be subject to this proposed rule. They would have to pay tax on the accrued gains on their assets even though they would be returning to Canada in a relatively short time. The experience to be gained from an overseas assignment would have to be weighed against a punitive tax situation. Similarly, temporary residents working in Canada would be compelled to value all their assets on their arrival in Canada and on departure to pay tax on gains that accrued on those assets during their stay in Canada. The deemed realization proposal as it relates to personnel transfers would place a real barrier in the way of temporary assignments in and out of Canada. It would cause serious difficulties in advancing employees through overseas assignments with the result that both the industry and Canada would suffer.

THE ASSOCIATION RECOMMENDS THAT THIS PROPOSAL BE REJECTED.

3. Pensions

Employees in this industry, as in other industries, participate in private pension plans in various forms. The proposal is that pensions paid to persons living outside Canada would be subject to a withholding tax which might be as high as 25 per cent but with provisions for lower or higher rates if circumstances of the recipient warrant. Presumably the decision as to the recipient's circumstances will be made by the Minister.

THE SUGGESTION THAT WITHHOLDINGS DEPENDING ON THE CIRCUMSTANCES OF THE INDIVIDUAL RECIPIENT BE MADE PRESUMABLY AT THE DISCRETION OF THE MINISTER WITHOUT LIMITATION SHOULD BE REJECTED OUT OF HAND.

4. Stock Options

The White Paper does not specifically discuss stock options. However, it is our understanding that any benefits realized on stock options exercised after implementation would be treated for tax purposes under the rules proposed for capital gains in the case of widely-held corporations but as ordinary income in the case of closely-held corporations. Options have proven to be extremely effective in North America for first attracting to industry and then motivating creative and individualistic personnel at the professional and technical level. In order for Canada to maintain and increase its position in the international community, it will require an increasing pool of such highly capable and motivated people.

CONSEQUENTLY, THE ASSOCIATION RECOMMENDS THAT ALL BENEFITS FROM OPTIONS ON SHARES OF WIDELY-HELD OR CLOSELY-HELD CORPORATIONS BE SUBJECT TO OUR PROPOSED CAPITAL GAINS TREATMENT. IN NO EVENT SHOULD EXISTING OPTIONS RECEIVE LESS FAVOURABLE TREATMENT THAN WOULD BE ACCORDED UNDER CURRENT TAX RULES.

APPENDIX A

COMPARISON OF INCOME TAXES PAYABLE BY AN INDIVIDUAL RESIDENT OF CANADA WITH INCOME TAXES PAYABLE BY AN INDIVIDUAL RESIDENT OF THE UNITED STATES FOR THE FIVE YEARS ENDED DECEMBER 31, 1974

Case 1. **Income** Salary $10,000

Long term capital gain .... $ 5,000

	1970	1971	1972	1973	1974
Taxes payable on salary only:					
CANADIAN RESIDENT	$1,780	1,780	1,780	1,780	1,780
UNITED STATES RESIDENT	1,122	1,019	962	905	905
Taxes payable on salary plus capital gain where gain is realized by:					
CANADIAN RESIDENT on –					
A. Widely-held Canadian companies' shares	2,660	2,660	2,660	2,660	2,660
B. Closely-held Canadian companies' shares	3,590	3,590	3,590	3,590	3,590
UNITED STATES RESIDENT	1,640	1,468	1,371	1,309	1,309
Increase in taxes resulting from inclusion of long term capital gain:					
CANADIAN RESIDENT:					
A. Widely-held Canadian companies	880	880	880	880	880
Effective rate of tax on capital gain	17.60%	17.60%	17.60%	17.60%	17.60%
B. Closely-held Canadian companies	1,810	1,810	1,810	1,810	1,810
Effective rate of tax on capital gain	36.20%	36.20%	36.20%	36.20%	36.20%
UNITED STATES RESIDENT	518	449	409	404	404
Effective rate of tax on capital gain	10.36%	8.98%	8.18%	8.08%	8.08%

ASSUMPTIONS USED IN CALCULATIONS:

(1) "White Paper" proposals in effect for Canadian Residents commencing January 1, 1970.
(2) United States calculations give effect to tax reform of 1969.
(3) Married individual with two dependents under 16 years of age. Joint return for United States purposes.
(4) Standard deductions for donations, medical and employment expenses in both cases.
(5) Canadian individual resident in British Columbia – U.S. individual resident of Ohio – two of the lowest taxing jurisdictions in the two countries.
(6) Shares on which capital gains are realized have been held for more than 6 months.

Prepared by **PRICE WATERHOUSE & CO.**

APPENDIX A

COMPARISON OF INCOME TAXES PAYABLE BY AN INDIVIDUAL RESIDENT OF CANADA WITH INCOME TAXES PAYABLE BY AN INDIVIDUAL RESIDENT OF THE UNITED STATES FOR THE FIVE YEARS ENDED DECEMBER 31, 1974

Case 2. **Income** Salary $15,000
Long term capital gain $10,000

	1970	1971	1972	1973	1974
Taxes payable on salary only:					
CANADIAN RESIDENT	$3,590	3,590	3,590	3,590	3,590
UNITED STATES RESIDENT	2,204	2,018	1,864	1,820	1,820
Taxes payable on salary plus capital gain where gain is realized by:					
CANADIAN RESIDENT on –					
A. Widely-held Canadian companies' shares	5,652	5,652	5,652	5,652	5,652
B. Closely-held Canadian companies' shares	7,956	7,956	7,956	7,956	7,956
UNITED STATES RESIDENT	3,485	3,235	3,060	3,010	3,010
Increase in taxes resulting from inclusion of long term capital gain:					
CANADIAN RESIDENT:					
A. Widely-held Canadian companies	2,062	2,062	2,062	2,062	2,062
Effective rate of tax on capital gain	20.62%	20.62%	20.62%	20.62%	20.62%
B. Closely-held Canadian companies	4,366	4,366	4,366	4,366	4,366
Effective rate of tax on capital gain	43.66%	43.66%	43.66%	43.66%	43.66%
UNITED STATES RESIDENT	1,281	1,217	1,196	1,190	1,190
Effective rate of tax on capital gain	12.81%	12.17%	11.96%	11.90%	11.90%

(Based on the assumptions previously outlined).

Prepared by **PRICE WATERHOUSE & CO.**

APPENDIX A

COMPARISON OF INCOME TAXES PAYABLE BY AN INDIVIDUAL RESIDENT OF CANADA WITH INCOME TAXES PAYABLE BY AN INDIVIDUAL RESIDENT OF THE UNITED STATES FOR THE FIVE YEARS ENDED DECEMBER 31, 1974

Case 3. **Income** Salary $25,000

Long term capital gain $25,000

	1970	1971	1972	1973	1974
Taxes payable on salary only:					
CANADIAN RESIDENT	$ 7,956	7,956	7,956	7,956	7,956
UNITED STATES RESIDENT	4,982	4,668	4,444	4,380	4,380
Taxes payable on salary plus capital gain where gain is realized by:					
CANADIAN RESIDENT on –					
A. Widely-held Canadian companies' shares	14,221	14,221	14,221	14,221	14,221
B. Closely-held Canadian companies' shares	21,202	21,057	20,912	20,766	20,621
UNITED STATES RESIDENT	9,738	9,248	8,954	8,870	8,870
Increase in taxes resulting from inclusion of long term capital gain:					
CANADIAN RESIDENT:					
A. Widely-held Canadian companies	6,265	6,265	6,265	6,265	6,265
Effective rate of tax on capital gain	25.06%	25.06%	25.06%	25.06%	25.06%
B. Closely-held Canadian companies	13,246	13,101	12,956	12,810	12,665
Effective rate of tax on capital gain	52.98%	52.40%	51.82%	51.24%	50.66%
UNITED STATES RESIDENT	4,756	4,580	4,510	4,490	4,490
Effective rate of tax on capital gain	19.02%	18.32%	18.04%	17.96%	17.96%

(Based on the assumptions previously outlined).

Prepared by **PRICE WATERHOUSE & CO.**

APPENDIX A

COMPARISON OF INCOME TAXES PAYABLE BY AN INDIVIDUAL RESIDENT OF CANADA WITH INCOME TAXES PAYABLE BY AN INDIVIDUAL RESIDENT OF THE UNITED STATES FOR THE FIVE YEARS ENDED DECEMBER 31, 1974

Case 4. **Income** Salary .... $ 75,000

Long term capital gain $250,000

	1970	1971	1972	1973	1974
Taxes payable on salary only:					
CANADIAN RESIDENT	$ 36,119	35,445	34,770	34,096	33,421
UNITED STATES RESIDENT	29,259	28,215	27,520	27,420	27,420
Taxes payable on salary plus capital gain where gain is realized by:					
CANADIAN RESIDENT on –					
A. Widely-held Canadian companies' shares	122,530	116,253	109,975	103,698	97,421
B. Closely-held Canadian companies' shares	218,343	204,112	189,882	175,652	161,421
UNITED STATES RESIDENT	102,546	105,715	105,698	105,570	105,570
Increase in taxes resulting from inclusion of long term capital gain:					
CANADIAN RESIDENT:					
A. Widely-held Canadian companies	86,411	80,808	75,205	69,602	64,000
Effective rate of tax on capital gain	34.56%	32.32%	30.08%	27.84%	25.60%
B. Closely-held Canadian companies	182,224	168,667	155,112	141,556	128,000
Effective rate of tax on capital gain	72.89%	67.47%	62.04%	56.62%	51.20%
UNITED STATES RESIDENT	73,287	77,500	78,178	78,150	78,150
Effective rate of tax on capital gain	29.31%	31.00%	31.27%	31.26%	31.26%

(Based on the assumptions previously outlined).

Prepared by **PRICE WATERHOUSE & CO.**

APPENDIX "C"

Submission

by

DENISON MINES LIMITED

on the

PROPOSALS for TAX REFORM

to

THE HOUSE OF COMMONS STANDING COMMITTEE
ON FINANCE, TRADE AND ECONOMIC AFFAIRS

AND

THE STANDING SENATE COMMITTEE
ON BANKING, TRADE AND COMMERCE

June 1970

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INTRODUCTION

Denison Mines Limited, is a relatively young company which has nonetheless played a significant role in the development of Elliot Lake, a previously undeveloped part of Canada, and of the largest uranium mine in the world. This mine has served as the wellspring for diversification of the Company into oil production in Alberta and cement production and building materials in Ontario. Mineral exploration activities are currently being carried on in six of Canada's provinces, one of its territories and five foreign countries. Sales of uranium and cement are conducted on an international basis. In addition, the Company has major investment positions in a wide variety of fields, both in Canada and abroad.

For us, Canada has been a land of opportunity—where initiative and risk have been rewarded—where success for the Canadian economy has been shared with those who helped make the success—and where one success can be used to build another—for both the builder and the people of Canada.

We think this linking of performance with reward is still important—perhaps more important than ever in a world where many young and not so young people question the very worth of performance. We think entrusting scarce resources to those who have proven an ability to make good use of them also remains important. And we think that building up for the future, for ourselves and for coming generations, is still a powerful human motivation that should not be carelessly discouraged or frustrated.

Our approach to the White Paper is primarily based on this experience and this philosophy. For this reason, our brief will present this philosophy and suggestions based upon it. This philosophy has been at the heart of the Canadian economy and a central reason why it has done well for Canadians. We think Canadians know this and that they will reject tax reform that fails to take it into account.

This brief concentrates on the development of an appropriate tax philosophy for Canada in the seventies, rather than on the details of

particular proposals of the White Paper. This philosophy differs in a number of important respects from the apparent approach of the White Paper. Philosophy is in our opinion the key question raised by the Proposals for Tax Reform. Support for or opposition to particular changes is not as important as the reasons for such support or opposition. We have made a determined effort to articulate and develop carefully our reasons for support or opposition.

Our approach attempts to reflect a long view. Our concern is for the ecology of our kind of economic environment. Our test is whether changes will strengthen or weaken the essential health of our economic environment which is the foundation of all equity, just as our natural environment is the foundation of all life.

We commend the most serious study of the implications for our economic environment of any tax measures which would favour consumption over savings and which would shift the balance even more away from individuals and private groups toward the state. These are the two central issues raised by any tax reform in Canada for the seventies.

1 Economic Environment and Tax Reform Perspectives

1.1 Canada inherited a matchless natural environment. Unwittingly, and, regrettably, also wittingly, we have begun to threaten it seriously. We have slowly learned about the ecology of our natural environment—for example, of how products which have passed every other test still fail the ecology test—because cumulatively through time they damage the very environment itself. We now know that we can irreversibly pollute a Great Lake—or even the Arctic. But this has been largely hindsight. Unfortunately, foresight cannot be proven in advance.

1.2 We are already seeing how a little bit of inflation that no one worried much about can pollute the economic environment. All the weapons in the modern economic arsenal are not finding inflation easy to fight at acceptable cost. This fight against inflation has become a very messy business which is dangerous to our society and economy. A thoughtful and careful approach is essential when the main cost of economic mismanagement is paid by the poor and unemployed.

1.3 The natural response to the difficulties of running more and more of the economy from Ottawa would be to turn more resources back to the people. Now is the time to let those close to the action make more of the decisions, take more of the risks and accept more of the consequences—when those far from the action aren't doing too well. Regrettably it is not generally in the nature of bureaucracies to reduce their claims on resources. Their view seems to be that if only they had more rather than less, they could do the job. Yet the broad negative reaction towards increased taxes which we have been witnessing should be a warning signal to those who still drink deeply of the conventional wisdom that government expenditures must forever lay claim to increasing portions of the national income.

1.4 We recognize that there is a need for public expenditure on many programs including new programs. But needed expenditures should be

financed primarily by pay-as-you-go taxation of income and consumption, if the real benefits of a dynamic economy are to be realized. We are now re-learning the old lesson that he who would build a house must first sit down and count the cost, to see whether he can afford it. Having failed to do this in the sixties, we are now paying the price in inflation, unemployment, record high taxes and reduced economic growth. Everyone knows how unfairly this price is distributed among Canadians.

1.5 Canadians are far from convinced they are getting full value for their tax dollar. Much of the present government revenue requirements and related inflationary pressures are due to new government expenditure programs, for which no sound forward estimates were given. No matter what tax system is adopted, until government expenditures are based on sound planning and full disclosure, no one should be expected to feel his taxes are fair.

1.6 Thus radical tax reform before expenditure reform is to put the cart before the horse. This approach lacks the simple qualities of credibility and good sense. Who else would knowingly dare such an approach except those who have become accustomed to thinking of themselves as the sole custodians of what is good for Canada.

1.7 No one man or group of men can make an exclusive claim to advancing the well-being of Canada. The responsibility rests on all and the only test is results. Canada has been built on the foundations of individual effort and initiative. Acceptance of the view that governments are inherently better spenders or investors of the earnings or savings of the private sector can only be destructive of these foundations. Blank cheques must not be given in advance. Each of the claims of government for more money must be proven one by one. No other approach will be acceptable to Canadians whose individual ambitions are increasingly thwarted by high prices, high interest rates and heavier taxation.

1.8 What Canada needs is the prescription of some reality therapy for its affairs—a recognition of the hard but simple truth that a good

life on this planet has always needed and still needs a good effort, and that the full effort needed won't be forthcoming if the fruits of that effort are unfairly dealt with.

1.9 A tax system does not exist in isolation as a thing in itself. It is of central importance to the condition of the economic environment. In a word, we must not only guard the natural environment for ourselves and future generations, we must guard the economic environment as well. Not everything is right in Canada—but we would do well to ask ourselves whether we would prefer any other significantly different economic environment to the one we have. For on the whole it has served Canadians extremely well by world standards. There is every expectation it can do even better in the seventies, if we grasp the opportunities.

1.10 Tax changes as such are one thing. But tax changes which would radically alter the economic environment are something else again. The first charge on Canadian economic policy is to preserve and strengthen the economic environment—so this must also be the first test of tax reform. The onus is on those who propose radical change to establish that it will preserve and strengthen the economic environment.

1.11 It is easy to be glib about likely effects in a single year—and suggest minor adjustments may be easily made by the flip of an economic dial. But the balance of the economy, like the balance of nature, cannot safely be ignored. Imbalances can be very difficult to set right, as we are witnessing in the present fight against inflation.

1.12 Canadians can now see that inflation control and economic growth through improved productivity are the essential foundations of any economy that hopes to be fair. It doesn't really matter how beautiful Nero's music may be, if Rome still burns. The same goes for tax changes bought in the name of equity at the expense of the economic foundations of all equity. What poor or inflation-ridden society can we point to that is also fair? It is not an acceptable road to greater tax equity to accept a reduced performance from the economy. There could be no more cruel deception than this whether

by error or design—and as is always the case, it will be the hopes of the expectant disadvantaged that will be most dashed. We do not say that economic efficiency and equity are one—only that you get the most of each when they are effectively linked together. Unfair societies are not as efficient as they can be and inefficient societies are not as fair as they can be. The inefficiencies of inflation and unbalanced economic growth have produced far more unfairness in a year than the worst defects of the present tax system have in a decade.

1.13 Achievement—in small things and in great things—is a positive human trait. The most human society is the one that most encourages achievement of every kind by individuals—a society that provides the framework for independence rather than dependence. In today's world, we must work together as well as alone. But it is independent men, not dependent men, who work best together. Individual achievement is not an anachronism, as some may think, but the very oxygen of a free society.

1.14 Achievement has two conditions—a worthy challenge and the incentive to meet the challenge through initiative and effort. Canada is full of challenge. Let us also be certain it is full of incentive, so that there will always be the initiative to meet the challenge. For only an incentive society can be a great society.

1.15 The size and complexity of our society is often used as an excuse for more and more central control. But this is defeatism. Canada still has a chance to learn from others and avoid the dehumanizing effects of living in a society where individual effort is felt to count for less and less. Centralized bureaucracies are surely not the path of the future—or the approach Canada would like to take. Decentralization—leaving resources in the hands of the people who earned them and of governments closer to the people than the central government—must be the key to any tax reform that aims to strengthen rather than weaken the individual, especially the individual who will respond to the incentive of opportunity.

1.16 These then are the perspectives for tax reform, if it is to serve Canada in the coming decade.

2 Appraisal of the White Paper Approach

2.1 How well does the White Paper reflect the imperative of preserving and strengthening the economic environment which is the only basis for improving both fairness and the quality of life? Not very well at all. Unfortunately, three of the major requirements—savings, inflation control and the growth of international trade and investment—and their relationship to economic growth and social needs—receive minimal consideration.

2.2 We have discerned six main elements in the White Paper approach to tax reform:

- **the social objectives;**
- **the equity aspects;**
- **the structural aspects arising out of the decision that the social and equity objectives could only be met by a radically different tax structure;**
- **the virtual absence of any assessment of the proposals in the light of major national objectives for the seventies—the stress on only the income tax part of the total tax system;**
- **the sheer size and scope of the proposals in relation to the digestive capabilities of the legislators, the tax administration, the taxpayers and their advisers; and**
- **the clear thrust of the White Paper to increase taxes on a basis which ensures that a steadily increasing share of the national income will go to the federal government.**

Social Objectives

2.3 A major social objective of the White Paper is to relieve the level of taxation on lower income Canadians through higher exemptions. This can be achieved within the framework of the present system. Indeed, having regard to inflation, some revision is at least ten years or more overdue.

2.4 Similarly, recognition that employees and working mothers incur expenses to earn income is long overdue. The employee deduction proposals will provoke no dispute among Canadians, unless to assert that the proposed provisions are not as fair as they might be relative to the tax treatment of expenses of other taxpayers.

2.5 Generally, the proposed inclusion of current income items not presently included in taxable income is fairer and thus productive of social benefit. However, a serious departure from the usual principle of including in income amounts flowing from previously deductible expenses is noted in the case of strike pay which comes out of tax deductible union dues.

2.6 There is also the question of tax avoidance. Here, the only question is as to means, not ends, once a scheme of tax avoidance that is improper has been identified. A problem may arise as to what is indeed improper avoidance. For example, under the White Paper closely-held share gains are to be taxed in full while only half of widely-held share gains are to be taxed. The White Paper appears to contemplate only half-tax treatment for closely-held shares sold in the process of becoming widely-held shares. Thus, today, it may not seem tax avoidance to "go public" and so cut the capital gains in half. But perhaps tomorrow it will, especially if special "go public" vehicles are created for this very purpose, so that the full tax is seldom if ever collected on closely-held shares. We may find stamp collections and paintings going public to get the lower rate. And why not? If a business or land can do so, why not stamp collections, when all are being treated alike at the 50% rate? And yet, will those who cannot go public feel that they are being fairly treated? Is this what we want from a tax system?

2.7 Many of the features of the present tax law complained of in the White Paper are in this category. At one time, they were regarded as proper—now they are regarded as being improper. What makes a tax legally avoided also improperly avoided? How can one tell in advance, especially if the government has not been able to do so or has not seen fit to do so? And if one can, why not say so in the law?

2.8 In too many cases, the sound "let the punishment fit the crime" approach is abandoned for the approach that if anyone has ever committed or might ever be able to commit "a crime," everyone must be punished. This is not a sound approach. The proposed global approach to "loopholes" is neither fair nor socially constructive. All Canadians will support elimination of "genuine" loopholes. But serious questions need to be raised about the White Paper approach. Are all the alleged loopholes really loopholes? And even if they are, must they be dealt with by major structural changes with serious and uncertain side effects?

2.9 The final social objective is to subject capital gains to tax. However, the case is far from clear for a country with the fantastic potential for development which Canada has. More important is the possibly unintended effect and thrust of the White Paper not simply to tax capital gains, but to do so in a way that, along with other changes, will seriously downgrade and impair the role of private capital in Canadian hands. If capital gains are to be taxed, it is essential that the tax be structured so that the adverse effects on savings and risk taking are minimized, and so that there is a minimum impact on the efficiency of capital markets. We expand upon our views in this regard in Chapter 3.

2.10 Two separate but closely linked social objectives do not appear to be among the objectives of the White Paper. The first is the importance of strengthening the individual element in our society through incentives to achievement. The second is the importance of strengthening the pluralism of our society by seeking to broaden the direct participation of more Canadians in their own economy through savings and investment. It is essential that they be included among the social objectives of the ultimate tax reform.

Equity Aspects

2.11 There is little doubt that widening the tax base by including many previously excluded items of income and broadening deductibility of legitimate employment expenses improves the equity of the tax system. While this is important, this is regrettably the only

significant equity contribution of the proposals. Of course, the reduction of unrealistic and punitive top rates is equitable, but the balance of the rate structure changes do not improve equity for middle income taxpayers, but rather worsen it.

2.12 While a top 50% rate is sound in principle, we do not count on it being held by both federal and provincial governments. We are thus wary of the inflexibility of a system which depends on a roughly equal top corporate and personal rate. For example, a top corporate rate of 54% and a top personal rate of 56% will mean an effective 60% rate on distributed or integrated business earnings of closely-held corporations. This increase of 20% over the 50% proposed rate is not insignificant—and, constitutes a real threat to the viability and reality of the integration proposal—especially as each of these rates is only slightly higher than the 50% and is quite in line with some existing rates when the provinces are taken into account.

2.13 The equity defects of the White Paper proposals are several—and major:

- unreal inflationary gains will be taxed without alleviation, while real losses will not be fully recognized where inflation is significant;
- the proposed exemptions and rate levels will become increasingly inappropriate in real terms through the effects of inflation.
- the different integration and capital gains rate proposals for closely-held, widely-held and foreign corporations will create a host of inequities between people in essentially the same position, depending on their status and their ability to shift from a less favourable to a more favourable status. These inequities will be dramatic in many cases—and could be an incitement to tax manipulation;
- the negative effects of the White Paper proposals on economic growth and inflation control will hurt every taxpayer but especially the lower income taxpayers;

- the taxing of small corporations on the same basis as the largest corporations merely strengthens the advantage that the large always have over the small;
- the man who creates and saves may be subject to a combined 75% estate and capital gains tax, while the man who spends may be subject only to a 25% capital gains tax;
- the roll-over of capital gains taxation on death will, in practice, discriminate severely between those who leave assets that must be sold, thus attracting capital gains taxation, and those who can avoid such a sale;
- proposals which frankly set out to discriminate against non-residents may appeal to self-interested nationalism, but can hardly represent an improvement in equity. It is the essence of equity that it be capable of application to all. Where it cannot be so applied, whatever else it may be, it is not equity; and
- the proposal to deny legitimate business expenses presently deductible for the purpose of determining taxable income. It is not fair to tax income while denying deduction of the costs of earning it.

Structural proposals

2.14 None of the three requirements of good structure are present in the structural proposals of the White Paper:

- durability
- understandability
- flexibility

The integration of personal and corporate taxes, the distinctions between three forms of corporation, and the differential capital gains treatment of different shares and real assets would create such complexity, inflexibility, inequity of treatment and tax motivated decision making that the new system would be inherently unstable.

2.15 The tax stakes of different status will be so high that the system will come under severe strain almost immediately. The choices

will involve 50% tax reductions on dividends or capital gains, 50% increases in loss deductions, and from generation to generation avoidance of capital gains taxation, depending on how deals are structured. Past experience makes it quite clear that the results of this will not long be tolerated, so that the instability will quickly lead to a lack of durability as well.

2.16 The case for radical reform of the tax structure is far from proven in the White Paper. The alleged need for radical reform is largely a facile assertion that has gained some currency through frequent unthinking repetition, more by way of ritual chant than documented evidence. The hard gains for people are not documented while the disadvantages are numerous and clear. The case for radical reform does not arise so much in the real world as in the minds of theoreticians who are seeking the conceptually pure tax system as a thing in itself—a modern day version of art for art's sake. This may be suited to the groves of Academe—but not to the reality of Canada in the world of the seventies.

2.17 A stated aim of the revised tax structure is to reduce tax motivated decisions by putting capital gains and income on a comparable tax basis and achieving a common personal and corporate tax rate so that corporate and personal tax can be integrated—thus eliminating the so-called surplus problem. The authors of the White Paper proposals had to recognize that this approach will not work for the large corporations that do most of the business in this country. Despite this sound conclusion, they would still not let go of the twin ideas of capital gains as income and integration of corporate and personal income tax. They failed to recognize the distortions and instability inherent in two sets of rules and effective tax rates applied to essentially the same assets and income and they have tried to cure an admittedly unworkable approach by applying it only half way. Instead, they should have faced the fact that if treating gains as income and the corporate tax as a tax on shareholders would not work for most business in Canada this logically required abandoning once and for all as unworkable both capital gains as income and inte-

gration for all assets and corporations. The resort to the closely-held widely-held distinction and to half-gains as income and half-integration is simply an unsuccessful salvage operation.

2.18 Three further structural deficiencies are clear but are not recognized in the White Paper:

- if capital gains are to be taxed, they must be taxed on a separate basis which reflects their different character. It is one thing to say the growth of the tree is to be taxed—quite another to say it is to be taxed as though that growth were the equivalent of edible fruit, or that taxing the tree will have no effect on the quantity of fruit;
- if shareholders in Canadian companies are to be relieved of tax on dividends, this should be done directly rather than by saying the corporate tax is wholly or partly a tax on shareholders—which in a large number of cases it probably is not. It is unnecessary to weave vast unprovable theories to take such a simple step; and
- if there is any possibility that governments, federal or provincial, may want higher than 50 per cent rates for either or both of personal or corporate taxes, as there certainly seems to be, it is folly to hang an entire new tax structure by the thin uncertain thread of top 50 per cent rates, however desirable those rates may seem. It is unreasonable to expect that federal and provincial governments, over the years to come, will collectively man the ramparts and defend the 50% rates to the end. This being so, a system which depends so heavily upon this single thread should never be introduced.

2.19 People don't like to be told the "system" won't let them do what they want. It is thus unreasonable and impracticable to bind future generations by introducing a system with rigid requirements. Rather we should retain a flexible system where changes in corporate income tax can occur without requiring changes in the personal income tax, and vice versa, and where changes in the taxation of income can occur without requiring changes in the taxation of capital, and vice versa.

The integrated personal and corporate tax coupled with capital gains as income simply puts too many different things into the same basket for changes to be made easily or smoothly. Surely no one believes that we are getting an unique timeless tax system immune from the corruptions of time or the changing aspirations of men.

2.20 We might be less concerned if there was some encouraging evidence from other countries that these approaches, despite their apparent disadvantages, might actually work in practice. Unfortunately, the only evidence is negative.

2.21 Finally, there is no public demand for these structural changes. There is no widespread insistence that capital gains be taxed more heavily in Canada than in the United States. The tax technicians in the private sector do not support the need for these different classifications of companies, with radically differing tax treatment. Rather, their rejection is unanimous. Nor do these technicians regard half-integration as remotely the technical equivalent of the full integration that has been rejected for most of the business income in Canada—or as having material advantages over the simpler, more flexible and time-tested dividend tax credit. The question that arises is—who does want this new tax technology?

2.22 The answer is—whoever they are, there can't be many of them. And whatever makes them want the new technology has no discernible link with the social objectives of the reform unless, of course, the downgrading of the role of private capital in Canadian hands is regarded as an important social objective. In that case, we would predict rejection of such an approach by Canadians, once they understand that the true meaning of the new tax technology is not just technological but ideological—calling for the transfer of still more resources into the hands of the state, while leaving less in the hands of the public and/or private enterprise.

2.23 The English poet William Blake was able to see the whole of the world in a grain of sand. The authors of the White Paper seem to have had a comparable vision. But no practical engineer has ever based any plans on Blake's vision. It is equally unworkable to base

tax reform on a vision which sees capital as income and the corporate tax as a tax on shareholders, while remaining unable to see all corporations as corporations, all people as people and all investments as investments.

2.24 Tax structure should be related to objectives. It is important to note that none of the social objectives of the White Paper require a radical new income tax structure, while the most important equity defects of the White Paper proposals flow from the proposed new structure.

National Objectives Test

2.25 Fair treatment in taxation is unquestionably an important national objective. So too is recognition of the actual impact of the tax system on lower income Canadians. There can be no objection that these objectives were given a high place in testing proposals for tax reform.

2.26 It is important to note that these are people tests—which is as it should be. None of the changes proposed in respect of the basic structure, capital gains, international income or the mineral industries are suitably subjected to the national objectives or people test. Rather, they are approached from the far too narrow focus of federal income taxation as a thing in itself largely divorced from economic effects and other taxes.

2.27 The tax system as a whole—and not just the income tax part of it—is a major instrument for achieving national objectives. But like any instrument, it must be designed for particular purposes if it is to help achieve them. A basic defect of the White Paper approach is its excessive emphasis on the problems of tax technology and an insufficient recognition of national objectives in people terms. It cannot be repeated too often that the only source of real and lasting improvements in the well-being of people comes from high productivity economic growth.

2.28 Thus in the White Paper the technology problems of the dual corporate rate took precedence over the people problems of small business and their importance for the renewal of the economy by a continuous stream of new entrants.

2.29 Similarly, the difficulties of distinguishing capital gains from income in some marginal cases led to a decision to ignore the real differences between them and the acceptance of the adverse economic and social consequences of taxing capital gains as income.

2.30 Further, the ambition for a radically new tax structure based on concepts not accepted anywhere else has led to proposals which would produce several potential adverse side effects. These would be seriously detrimental to savings, inflation control, international competitiveness, high productivity industry, new innovative business, regional balance and development, Canadian ownership and the Canadian stake in efficient and non-discriminatory national and international capital markets.

2.31 How could this happen in a major government document? There would appear to be two principal reasons:

- the feeling that a timeless basic tax system was the most important thing to discover and work out; and
- the feeling that fiscal and monetary policy, and perhaps government loans and grants or government corporations such as a Canada Development Corporation, can offset the damaging implications of the White Paper for growth, inflation control and regional development.

2.32 The fact is that our national objectives will not be easy to achieve and all our policies should mutually support each other. We can't afford the luxury of a tax system at cross purposes with national objectives. The very rigidity of the tax structure package—capital as income, the corporate tax as a tax on shareholders, and a common top corporate and personal rate—drastically reduces the flexibility of response that any large system needs in a period of

accelerating change like the seventies. It is ironic that at a time when established structures are more and more subject to searching criticism and substantial change, the Canadian income tax system—which is a major structure indeed—is to be virtually set in concrete, as far as future flexibility is concerned.

Size and Scope of Proposals

2.33 It is apparent we do not regard the White Paper proposals as constituting a tax meal from a master chef. But even if we did, we do not think it is possible to digest at a single meal the quantity of dishes contained in the White Paper.

2.34 Income tax is a very pervasive influence in our society and economy—and in the world economy as well. It is impossible to assess in a definitive manner the impact of radical change in such a pervasive influence. The range of initial, cumulative, and offsetting behavioural reactions of people inside and outside Canada is simply too broad to assess.

2.35 The number of skilled people able to grasp the implication of such major change, the number able to administer an infinitely more complex system and the number able to respond as taxpayers is each highly limited. There is simply no way the proposed plan is logistically feasible in an acceptable and relatively smooth way in anything remotely approaching a one or two year time-table. Insisting on more change than can be digested will almost surely mean less effective reform in the end. This would damage the credibility of government's ability to cope.

2.36 The major reforms should first achieve broad consensus—and then be introduced in an orderly fashion. To attempt more will jeopardize not only general tax reform objectives, but other equally or more important national policy objectives as well. The time for choice based on sound priorities and good payoff is here.

Share of National Income to Federal Government

2.37 The revenue implications of the White Paper suggest that little has been learned from experience. In the sixties, governments failed to reduce private demands on the economy to match increasing public

demands. Result: inflation. This happened by failing to tax to pay—in other words, a failure to match new expenditures with new tax revenues. Now, the reverse is proposed—to get in new tax revenues without any proposed new expenditures having been first presented to and passed by Parliament. In each case, the aim seems to have been to avoid having to face the public with the costs of particular expenditure programs at the time they were introduced. This "blank cheques" in advance type of approach is simply not acceptable to sensible Canadians in 1970.

2.38 Taxes have historically been the symbol of governments that have pressed the people too hard. A frank, open and responsible approach to any further increase in taxes is now an urgent priority if the viability of government itself is not to be threatened.

2.39 The White Paper fails the revenue test on seven counts:

- it involves an immediate increase in taxes on the basis of the tax take in 1969—probably in excess of one billion dollars when in full effect. This is a huge sum—and is at complete odds with the position of the federal government in requesting financial restraint. Is this an example of do as I say, not as I do? This approach strikes at the heart of the trust essential to effective government;

- no provision is made to increase exemptions and rate thresholds to reflect inflation. Not only is this unfair, especially for those below the top rates, but it would inflate the fiscal dividend already declared to itself by the federal government in the White Paper. Thus, in reality, the real tax increase in our inflationary environment will greatly exceed the one billion dollar figure. It is no answer to say the rates were set to produce a certain result in 1969, when the reform is proposed for 1971. If tax constraint were the policy of the White Paper, a little more work on figures would no doubt have been done, and rates at a much lower level projected. The fact this wasn't done suggests it wasn't intended or, at best, reveals a degree of insensitivity to the taxpayer that is unacceptable;

- the new system will not only produce more revenues of itself, together with the bonuses from inflation and real economic growth. It is also designed to produce a proportionately higher than ever before tax take out of each new growth or inflation dollar of annual income. It has been structured as a revenue producing machine beyond the fondest dreams of avarice—but all in the good name of tax reform and benefits for low income earners. The proposed revenue producing machine is undoubtedly an achievement of plutocratic dimensions. But the result is to make tax reform a benefit for government rather than for people;

- despite the apparent agreement that provincial-municipal needs are rising relative to federal needs it is federal revenues that will increase dramatically under the White Paper proposals. Before implementation of any major changes a reconciliation of the expenditure needs and tax revenues of these levels of government is essential. It is not practical to introduce major tax changes and major tax increases without agreement on these federal-provincial issues. A rigid narrow stand by the federal government on this point could have very serious implications for total tax burdens, as well as for the general acceptability of federal economic leadership;

- there is insufficient attention paid to the importance of economic growth as the only reliable generator of increased real revenues. Inappropriate taxation adverse to growth may result in a loss rather than gain in real revenues. It is a case of looking beyond the initial revenue effects to the longer run revenue effects after the tax changes work their way through the system;

- the approach to international taxation risks serious revenue losses to foreign treasuries; and

- the permitted deduction of capital losses against ordinary income could have serious effects on revenues at a time of low share and bond prices such as the present.

Summary

2.40 We are impressed with what we take to be the broad social objectives of the White Paper—but we are concerned about a serious misunderstanding of the role of capital in private hands and of individual initiative and effort in serving these objectives. However, we are satisfied that the overall equity of the tax system will be reduced rather than enhanced, and that the proposed tax structure will be more inflexible, less understandable and less durable than what we now have.

2.41 We are at a loss to understand the absence of any effective attempt to design tax provisions that would contribute to major national policy objectives, the unmanageable scope of the proposed reforms and the major tax increase implications of the new proposals.

2.42 The aim of tax reform should be to do a job for Canadians on a scale that is sensible and workable. It may be interesting to academic minds outside Canada to watch a vast tax experiment with Canadians as the guinea pigs. But being a guinea pig on a grand scale is a role that should be reserved for guinea pigs and volunteers.

3 Capital Gains

3.1 Our basic view is simple. Canada still needs the dynamic risk-taking and capital formation which the tax free treatment of capital gains has provided. Canada is young—a place of opportunity. The big win matched by the big keep of tax free capital gains is a proven spur to the risks and dedicated efforts which get new ventures started and financed—as well as an important source of savings in Canadian hands, especially for new risk ventures.

3.2 It is a form of intellectual colonialism that ill befits a pioneering vigorous country that we tamely follow the United States and the United Kingdom—both capital surplus developed countries—in imposing a capital gains tax at this stage in Canada's development. It is a form of policy bankruptcy to be espousing a policy of more Canadian enterprise for Canadians, while reducing through higher taxation of risk and capital the incentive to do the job and the savings available for the job.

3.3 Our attitude toward the taxation of capital gains is based on the view that capital and income are not the same thing; that the creation and preservation of capital can be a powerful motivation to savings, innovation and enterprise; and that capital has been and is our essential source of economic growth and thus individual well-being, especially where it is allied closely with entrepreneurial, managerial and technological skills.

3.4 Where in fact do capital gains come from? We have been able to identify only one source of real gains to the economy as a whole. The other four sources involve transfers of capital at increased values which do not represent real value increases to the economy, although they alter the ownership of real capital.

3.5 The only real source of gain to the economy is where a real capital value is created in excess of real costs. This is because the present value of the future stream of income is worth more than it cost to discover or create the source of income. In fact, the future

income from such a source will only be regarded as part of the national income when it is realized as income. But a system of taxing both capital and income will go further and tax the future income before it is realized by taxing the gain part of the present capital value of such future income—and will tax the future income again when it is actually realized. A system of taxing capital gains of this kind is nothing more than taxing income in advance of realization—a serious form of double taxation. As the income is not yet realized, it is a tax on capital. This is a very different thing from a tax on income, for what is taxed is not included in the computation of national income for the very good reason that it is not yet income.

3.6 The other four sources of capital gain are neither income nor real from the point of view of the economy, and never will be, even in the form of future income:

- inflationary gains arising from a decline in the value of money, which are illusory to both the holder and the economy;
- gains arising from a change in price-earnings ratios or interest rates—the fact that people will accept a lower rate of return than previously adds nothing directly to the total income of the economy although it results in a change from the previous monetary value of asset holdings;
- gains arising from a different assessment by the market of an asset value as a result of a revised expectation of higher future earnings—again adding nothing to the total income of the economy; and
- gains to shareholders arising from increased share prices reflecting increased retained earnings. These earnings will already have been included in national income. The increased share price reflecting retention adds nothing to the national income.

3.7 Any particular capital gain may involve one or more of these five elements. But in no case has real income yet arisen and in four cases it never will. What has been invested in real assets in the past

remains invested, however much the monetary valuation of it may have changed for any of these reasons, or however many times the equity or legal right in the real asset is transferred from one person to another.

3.8 What does all this tell us? It tells us that capital is not income—and that capital transfers are not income transactions, although services in effecting such transfers may properly give rise to current income. The very reference to "capital" markets reflects the recognition that the market allocation of capital funds is a different function from the income earning process.

3.9 If there is a case for taxing capital gains, it is a different case than for taxing income. Accordingly, different criteria must be applied in establishing the basis on which capital gains are to be taxed. The White Paper acknowledges that "a buck is a buck is a buck" is a shade on the simple side. For Canada in the seventies, with its need for more capital, enterprise, innovation and risk-taking than ever before, the criteria must be tough. If they are not tough enough, we will fall behind in international competition, economic growth and prosperity. If the name of the new game is to tax away more capital from private hands and put it in the hands of the government, let Canadians be told this. But let us not cloud this vital issue by trying to say capital gains are the same as income.

3.10 Here are the criteria:

- the base subject to tax and the rate structure must be set to recognize that many gains are not real but are illusory gains due to inflation. An inflation deflator would be ideal and must be seriously considered, along with a rate schedule separate from and lower than pay-as-you-go income rates. In any event the rates should be no higher than effective American capital gains rates and other treatment should be no harsher than American rules. All capital gains from shares and real business capital assets should be taxed on the same basis and at the same rates;
- capital should be treated as a pool in the same way as depreciable property. Transfers within the pool should be

free of tax. In this way, the efficiency of capital markets will be maintained by eliminating lock-in effects, which would be extremely serious under the White Paper;

- business inventory is valued at the lower of cost or market for income tax purposes. Any periodic revaluation proposal would thus apply a much harsher tax on capital than is now applied to inventory in computing taxable business income. It would also be an infinitely harsher test than the cash receipt test applied to almost all other income—including income from capital. A heavier tax on capital than on income must not be imposed in a decade which promises to find Canada capital short and subject to inflationary pressure. This is what results from the confusion created by trying to treat a gain on capital account as income;

- realization must be abandoned as a taxable event for capital gains. One of two things will happen if it is not. First, capital will be locked-in from generation to generation and cease to respond freely to market forces. Investment decisions will be dictated by tax consequences rather than economic merits. Second, every capital gains tax system requires some form of roll-over so as not to completely thwart economically desirable transactions. Thus the result of a realization approach is either the lock-in effect or the twisting of normal asset transfers to bring them within a defined roll-over situation. Canada is not so flush with capital that it can afford either of these inefficiencies in the operation of its capital markets;

- the proper basis is controlled roll-over for all capital realizations subject to their reinvestment. If capital gains are regarded as income, roll-overs may be considered unfair deferments of taxes otherwise due, although this would be equally true of inventory and capital cost treatment of business income. This is not so, once the different nature of a tax on capital gains is understood—namely taxing now on the basis of income yet to be earned. A capital gains tax is always the reverse of a deferment—rather it is taxing now on the basis

of an increased monetary value created by expected increased future income or a willingness to pay more for the same expected earnings;

- if capital is treated as a pool, the taxable event becomes withdrawal of capital for consumption. The penalty does not arise from making a change of investment based on economic merits, while still leaving the capital at work in the economy. Rather, the penalty is on consumption—a far more desirable approach especially for a period of capital shortage and inflationary pressure;
- under the capital pool approach there are two choices. One is the American approach of permitting a tax-free roll-over of capital gains on death together with a stepped-up basis in the hands of heirs, but continuing some form of estate taxation. The other is to eliminate estate and gift taxation and have a deemed realization on death for capital gains tax purposes; and
- the sounder approach is the latter resulting in a once-in-a-life-time taxation of capital gains retained in the capital pool. The result will be to largely eliminate tax considerations in capital transfers. In future, family capital transfers could be made on the basis of family requirements and business capital transfers could be made on the basis of economic merit.

3.11 The above approach to the taxation of capital has a number of important merits not present in the White Paper approach or in the approach of any other country. It would be a genuinely unique Canadian contribution to taxation, because it would be based on Canadian needs:

- it reflects the reality that capital and income are different, and that if capital is to be taxed, it must be on a different basis;
- it does not interfere with either business or family transfers of capital;

- risk-taking, capital creation and savings are slightly favoured and consumption slightly penalized. The present estate tax bias against saving and in favour of spending would be eliminated;
- only an individual's lifetime real gains from the economy are taxed—income annually and capital increments when spent or at death;
- taxes on these gains are paid once and only once; and
- the potentially serious damage to capital markets and government revenues of capital losses deductible from ordinary income would be avoided.

3.12 Realization as the taxable event has many economic efficiency defects. It also will be productive of significant unfairness as well. The generation to generation roll-over of all assets other than widely-held shares will help those who can avoid realization relative to those who for many different reasons may not be able to do so. Also, the effect of corporate provisions relative to amalgamation and take-over bids may compulsorily put a shareholder in a taxable realization position, regardless of his wishes in the matter. He may, for example, prefer cash to stock in a new company, yet face a tax on taking cash rather than stock. It is, of course, possible to attempt to deal with cases like these on a series of separate bases. But abandonment of realization for the capital pool approach combines maximum fairness with the most favourable economic efficiency and savings effects.

3.13 There is another way of contrasting the true economic differences between a realization and a capital pool approach. Take one taxpayer holding a $100 share, all of it representing capital gain and another with a $100 share, none of it representing capital gain. A new $75 share investment becomes possible. The first taxpayer must, in effect, pay $100 for the share, whereas the second taxpayer can get it for $75. This is because the cost of the money needed to buy is $25 higher to the first taxpayer—because he pays an excise (transfer) tax of $25 to get the $75 to pay. The anomalous situation results that the more efficient investor is always at a disadvantage relative to the less

efficient—because his cost of a new investment paid for out of sale of an existing investment will always be higher by the amount of the capital gains realization tax. It also means that for such investors, they can only afford to pay when they can find a $75 investment which is better than their existing $100 investment. This introduces a major inefficiency in the allocation of capital. This is avoided by the capital pool approach, where the economic cost to each taxpayer would be $75.

3.14 It is a strange fairness that penalizes the creator and saver of the wealth employed in the economy and favours the spender of the fruits. The spender of capital gains today escapes both income and estate taxation, while the saver is hit by estate taxation. In contrast under our proposals the spender would be hit when he realized, while the saver would only be hit once on death on accrued but real capital gains. Most people will feel this is a much fairer result, as well as one more conducive to savings, inflation control, economic growth and Canadian ownership. It is inequitable to look at what a man has and to ignore why he has it.

3.15 Private capital in Canadian hands makes an important contribution to the social and economic balance of the country. But more and more economic and other activity is channeled through large bureaucracies—government, business, labour and educational. The aim of tax reform should not be to strengthen the bureaucratic element in our lives, but rather the individual element. We should be seeking new ways to encourage more savings and investment by more and more Canadians instead of being disdainful of private savings and the efforts of individuals. Unfortunately, it is not possible to point to even a single White Paper proposal which will make a material contribution to private savings and investment. It is possible to point to a great many which work in the opposite direction.

3.16 At best, it is mischievous to say that the buck represented by the tree is the same as the buck represented by the apple. At worst, it means eating the goose as though it were the same as the eggs, while continuing to expect more eggs and more geese to eat. A lot of things have changed in the 20th century, but this is not one of them.

3.17 If we do not recognize the difference, one or more of three things can happen. And Canadians must understand this before they make a choice. First, there will be fewer trees and thus fewer apples. Second, there will be fewer trees owned by Canadians. And third, the government will own more of the trees that remain under Canadian ownership. Canadians want none of these results—but will surely get them, unless there is a better understanding of the role of private capital in our society than that implied by the White Paper approach.

3.18 Facts are not always fashionable. Reassuring fiction is frequently preferred. But the fact remains that tax free capital gains have been a dynamic element in promoting Canadian growth in competition with the huge economic power of a capital surplus United States. Not a scintilla of evidence has been advanced to support a need for change now in this long-standing policy by reference to changes in the facts of Canadian life. Not a word has been said about the many benefits to Canada of a policy which has had the support of a legion of past policy makers. Have we just discovered a truth which has hitherto escaped everyone else? The White Paper capital gains as income proposal would have been more convincing if evidence and arguments had been advanced to establish why change was needed now. The issue is not resolved by recourse to unproven ideology, slogans like "a buck is a buck is a buck", and meaningless comparisons with the United States of 1913. A major policy change with such social and economic implications merited more evidence and arguments than the capital gains proposal receives from the White Paper. Surely something better than American textbook economics of the twenties is needed to establish the wisdom of a capital gains tax for Canada in the seventies.

4 Corporations and Their Shareholders

4.1 We have seven main reasons for rejecting the proposed radical restructuring of the taxes on corporations and their shareholders:

- the reasons advanced in the White Paper that specified serious defects of the present system dictate a radical new structure do not withstand examination;
- the structure proposed rests on several errors of fact which arise in part from unrealistic economic theory developed in the United States under economic conditions very different from those existing in Canada today. The White Paper attempts modification of these theories for Canadian circumstances, but fails because the facts differ too much from those assumed in the original theories;
- there would be serious adverse effects on the important national objectives of regional development, high productivity, economic growth, inflation control, efficient Canadian capital markets, favourable access to international capital markets and more enterprise and development in Canadian hands;
- the structure as proposed will lack the essential qualities of durability, understandability, flexibility and equal treatment to make it a practically viable proposition;
- the so-called integration proposal fails to achieve a true integration of personal and corporate tax except, apparently, where the partnership option can be taken by a closely-held corporation;
- the introduction of a capital gains tax does not require radical restructuring of taxes on corporations and their shareholders as any capital gains tax must be separate from the income tax; and
- treating the corporate tax as a tax on shareholders, while not granting non-resident shareholders credit for Canadian corporate tax or resident shareholders credit for non-resident

corporate tax, opens up extremely difficult treaty-negotiating problems with the risk of substantial revenue losses to Canada.

Let us now examine a number of these reasons in more detail.

4.2 The defects of the present system as they relate to corporations and their shareholders which were complained of in the White Paper are principally four:

- income received directly by the shareholder is subject to immediate tax by him whereas the shareholder's tax is deferred on earnings retained. This begs the whole question. If the corporation and its shareholders are separate taxpayers, what deferral of tax is there? The corporation, that has earned the income, pays. The individual also pays, if and when he gets it. It is only if they are really the same taxpayer that deferral arises. The White Paper proposes integration and a top 50% tax by shareholders. If elimination of the tax previously deferred is acceptable, how can it be worse to defer the tax than not to pay it at all?
- dividend stripping and the corporate surplus problem is another example cited. First, this is no longer a significant problem by reason of changes in legislation and recent court cases. Any remaining problem can be resolved by something far less than the global approach proposed. But more important, what is the real problem? It is that on death, the estate of the owner of a private company faces estate taxes which may require withdrawals of undistributed income which will be subject to income tax as well. This has unquestionably been a problem, but the proposals will make it worse in a great many cases, and will only help those private companies whose values do not exceed their book worth, but have substantial retained earnings. These will tend to be the least dynamic companies, as growth companies are normally valued substantially in excess of their book worth. Instead, the existence of a capital gains tax means that even if it is avoided by not realizing a capital gain on death, it still hangs over the head of the heirs as the corporate surplus used to do—but

then, there was at least the escape of a sale for a tax-free capital gain, which will no longer be possible. The proposal actually aggravates the essential problem it is claimed to alleviate—the potential double tax at death;

- neutrality of capital gains and dividends. This has some merit, but is only one aspect of the much larger and more important question of the appropriate taxation of capital itself. The importance of this neutrality is overrated in the White Paper, and not always followed either. Moreover, the same essential result can be achieved by a much simpler and more straightforward approach; for example, a 25% dividend tax credit and a top capital gains tax of 25%, with deemed realization of capital gains on death and elimination of the estate tax. This would also be a real solution to the double tax problem as well. Further, in important cases, this neutrality does not apply under the White Paper. This is so with widely-held corporations which have insufficient creditable tax because of fast write-offs due to capital intensity or high risk, incentives such as depletion to resource companies, or Canadian international companies with foreign dividend income. In these circumstances, the more favoured investor may well be the non-resident. The non-neutrality favours selling for a capital gain rather than receiving a dividend with inadequate creditable tax. And there is certainly no neutrality between closely-held, widely-held and foreign corporations; and
- alleged defects of the dividend tax credit. Two complaints were voiced against the dividend tax credit. The first complaint is that a corporation may have paid no tax yet shareholders still get the dividend tax credit. The answer is the dividend tax credit should be related to an appropriate incentive to invest in Canadian companies and not to what taxes they pay, which are the subject of other rules regarded appropriate by Parliament. What companies are appropriate for this incentive? Canadian international and resource companies? Are there any more profitable areas for Canadian risk investment? Yet these are the very companies which suffer in the switch from a

dividend tax credit to integration. The second complaint is that the credit benefits high income earners. Actually, this will be a very minor practical problem if the top rate is 50%, as the amounts could hardly be significant. A more refined credit related to tax rate levels could be developed but on a cost-benefit basis. We doubt the complexity is worth the minor gains in equity.

4.3 The proposed closely-held widely-held integration structure also rests on three important errors of fact:

- the view that closely-held companies compete primarily with other such companies and partnerships or proprietorships—and that widely-held companies compete primarily with other widely-held companies. An examination of the real world quickly discloses this is not true in so many important cases that it cannot be ignored. There is the related fact that in a number of cases, the closely-held companies that can elect the partnership option are in a more favourable competitive position than those who cannot do so. The absence of creditable tax is not a concern to them;
- the view that the type of company rather than the type of business determines the ability to pass on corporate tax to customers. How could it be so? In reality, the real question is whether taxes are regarded as a cost to be recovered, like other costs, in price. Except in very small businesses, we have no doubt the answer is yes for the vast majority of businessmen. This means the whole premise of integration and the distinction between corporations is built on sand, with results that are entirely predictable in advance; and
- partial integration for widely-held companies must remain a theory rather than a fact as far as investment decisions at the corporate level are concerned. It is impossible for management to assess tax consequences for its many shareholders. But what will be fact is the effect on share prices and the increased cost of equity capital for Canadian companies without credit-

able tax. As many of these will be growth companies, one may expect a trend away from Canadian ownership of these companies, and that new issues of the largest and strongest of such companies will be placed in the United States or elsewhere outside Canada. The trend toward repatriation of listed securities from non-resident to Canadian hands aided by the dividend tax credit and tax-free capital gains will in many cases be halted and reversed.

4.4 The proposed structure will have a number of important adverse productivity and growth effects:

- the cost of equity capital to Canadian companies with important international interests and to Canadian owned mineral resource companies will increase due to the effect of insufficient creditable tax under the integration proposal;
- the failure to recognize the financing requirements of small business by dropping the lower rate of tax without any offsetting provisions will retard the growth of new and small businesses;
- savings in Canadian hands will be reduced through the adverse effects already mentioned above and by the harsh capital gains proposals;
- the reduced taxation of distributed private company earnings and, to a lesser extent, of distributed public company earnings, will result in higher dividend pay-out and reduced reinvestment of earnings. This was one important reason why the United Kingdom abandoned integration. This reason would be even more pertinent for Canada because of the proposed common top rate of 50% and the proposed treatment of capital gains. These would strengthen the incentive to distribute rather than reinvest earnings;
- capital markets will be less efficient because the distinction between corporations and the proposed type of capital gains taxation will produce an emphasis on tax rather than business motivated investment decisions; and

– these corporation distinctions and the problems of creditable tax will induce the structuring of holdings of shares and assets in unusual ways to take maximum combined advantage of favourable features of creditable tax, lower capital gains rates or deferral of capital gains. All of these actions would be on the basis of tax rather than business considerations.

4.5 Integration by way of gross-up and credit is sadly deficient as a method of integration in the many cases where there is no creditable tax or where the tax credits are stale-dated. Moreover, if the corporate tax is a tax on the shareholders, logic would require that a corporate tax exemption is likewise a shareholder's tax exemption. Is there any ground for a "now you see it" tax rule at the corporate level, "now you don't see it" tax rule at the shareholder level? Is there not a fundamental inconsistency? It is a peculiar integration where only the taxed income and not the untaxed income is integrated to the shareholder level.

4.6 A strange inversion occurs where there are economic growth incentives at the corporate level. For example, of four possible categories of companies in the mineral industry each with insufficient creditable tax because of growth promoting write-offs at the corporate level only the non-resident shareholder and the closely-held partnership electing shareholder can retain the entire benefit of the corporate tax incentive at the shareholder level. The widely-held shareholder will lose only half of the benefit as the integration was only partial. The closely-held no partnership electing shareholder loses the whole benefit. The White Paper claims that the corporation tax is wholly or half a tax on shareholders because it is not shifted in whole or part to consumers. If this is so, the part of income subject to no tax or reduced tax at the corporate level should also be subject to no tax or reduced tax at the shareholder level where the corporate tax is supposed to be borne in whole or in part. But if this logic—which is the partnership election logic—is carried through, a major argument against the dividend tax credit collapses, and the essential argument for the proposed integration collapses as well.

4.7 It is apparent that the proposed structure is adverse to important national objectives. What is even more striking are the bizarre results which will become a matter of course if an attempt were ever made to introduce the system. Is it conceivable that a system of such complexity could last? How long could the economy survive investment decisions where the paramount question became taxation effects and not business merits? For the reasons discussed in this Chapter and in Chapter 2 it is clear that the system would collapse almost before it got started, leaving us even further back than where we started.

5 International Aspects

5.1 Most of the international implications of the White Paper proposals are retrograde from the point of view of the international competitiveness of Canadian business, the Canadian interest in fiscal harmonization and the risks of Canadian revenue losses through treaty negotiations.

5.2 There is explicit discrimination in not recognizing any credit to non-residents for the shareholder's tax portion of the corporate tax, while recognizing the credit for residents. The dividend tax credit does not run into this difficulty, because it is a credit for dividends received from Canadian companies entirely unrelated to actual Canadian corporation tax paid. This discrimination could create serious treaty negotiation problems and dangerous risks of substantial revenue losses to foreign treasuries. It is not helped by the fact that we could not afford reciprocity with the United States if they adopted a similar integration system.

5.3 The failure to recognize corporate taxes paid to foreign governments as taxes on shareholders on the same basis as taxes paid to Canada is likewise discriminatory against Canadian investment abroad. It is contrary to the Canadian interest in favourable access to relatively free non-discriminatory international capital markets. It is contrary to the Canadian interest in the development of Canadian multi-national corporations. It is contrary to the Canadian interest in the most efficient investment of its available funds. It is contrary to the Canadian interest in being a base or intermediary for international capital, enterprise and management looking not only to Canada but to every part of the world. There is no substitute for being "in the swim". These discriminations reduce Canada's chances in this respect. And again, this aspect is not helped by the knowledge of how much more difficult and expensive, if possible at all, it would have been for Canada to be developed to its current state if other countries, especially the United States, had similar provisions discriminatory against investment in Canada.

5.4 There are two features of the proposed "tax haven" provisions that deserve comment:

- the "passive income" provisions should not apply to any income derived outside Canada which is connected to active business operations outside Canada. It is no loss but rather gain to Canada if some foreign income of Canadians is able to be taxed at low rates. Indeed, there would be no reason in principle for not permitting a special exempt Canadian company to receive such lower taxed income—a possibility now being studied in the United States; and
- the Section 28 (1)(d) tax-free treatment of dividend income from 25% owned non-resident corporations should not be denied to the above type of low-taxed income—or to business income from non-treaty countries. There are two reasons for the above approach. The first is to keep Canadian international business competitive. The second is to avoid a moralistic "Canada knows best" approach to the tax laws of other countries and to leave it to other countries to decide what taxes they want to levy. We do not like it when the United States exports its laws to Canadian companies. Is there any reason to think other countries will like it any better when we do to them what we don't want others to do to us? In effect, there are now to be "second class" countries. Is this the long-look future we are carving out for ourselves in the international arena? This is just another example of those who speak of standing up to Americans showing their profound subservience to ideas and practices from the United States, even where the Americans themselves have begun to have serious doubts. Surely, if a country feels a low income tax system in general, or a low tax on particular income, is appropriate, it is not for us to say we will nullify their law by picking up the tax slack unless it is Canadian source income that is escaping normal Canadian tax in the hands of Canadians.

5.5 There have no doubt been tax haven abuses. These can be cleaned up in four ways without recourse to the complex and competitively damaging "passive income" rules:

- where it is essentially Canadian source income that is being diverted out to the tax haven and back to Canada, there is good reason for specific direct action;
- where an unfair split of international income is made between a Canadian enterprise and a non-Canadian one, this can be dealt with under existing laws requiring fair pricing, or by appropriate expansion of these laws;
- where any material amount of "passive income" from foreign sources is not connected with business activity outside Canada, it too could be subject to special rules; and
- the elimination of surplus stripping should mean that realization of any so-called tax haven benefits will be subjected to Canadian tax when the money gets into the hands of the individual Canadian taxpayer for consumption.

5.6 There is a danger that an administratively tight or leak-proof tax system will prove economically airless as well. Not everything can be achieved by naked force, and some things have to rest on a general sense of fair play. The proposed departure tax treatment of personnel, including Canadian residents coming back and forth across the border, could produce the opposite to the desired effects—a "don't fence me in" psychology. Canada would be better to lose some tax revenue by ignoring departure taxes and base its tax regime to a reasonable extent on the basis that Canada is a good place for capital. A departure tax will not strengthen the position of Canada as a good place for capital, and this reality should overrule the narrow revenue or avoidance principles behind the departure tax.

5.7 Canada has many dealings with the United States and other countries. Generally, we have dealt from a position of support for non-discrimination in tax and other laws as they affect the free movement of capital. We have a great stake in maintaining and expanding the free flow of capital in response to economic opportunity. An ineffectual but nonetheless clear discriminatory approach to international investment can have far reaching effects well beyond tax

treaty negotiations, which themselves could result in lost revenue. The question that must be asked is "for what?".

5.8 We do not agree with discrimination against portfolio investment by individuals, pension funds or others in foreign securities. This may be the only way Canada, through such investors, can participate in many new areas of profitable business. Special restrictions might be necessary for balance of payments reasons. But until these are required, we should strengthen rather than weaken our involvement in international activity. Canadians can now hold their own on the world stage on the basis of performance. It is time government stopped trying to prolong Canadian dependency on the protection of Mother Ottawa. We have grown up, but as often happens, Mother doesn't seem to realize it yet.

6 Mineral Industries

6.1 The verbal recognition in the White Paper of the high-risk capital intensity of mining and the special benefits of mining to Canada was reassuring and appropriate. Unfortunately two of the specific proposals—replacement of the new mine tax exempt period and the depletion allowance by a fast write-off and a weak exploration incentive in the guise of depletion—fail to translate the verbal recognition into effective policy.

6.2 No single group of proposals more clearly demonstrate the need to assess tax reform by how it affects major national objectives on the basis of evidence rather than theory than do these two proposed changes in mining taxation. The immediate effect of these changes will be sharp reductions in earnings and cash flows and in the value of existing properties and new discoveries. It is hard to square this with the statement in the White Paper that only a moderate reduction in mining activity is anticipated. No evidence is adduced to support this statement and it would be contrary to all experience if major changes did not produce major results.

6.3 There are two questions to be asked:

- are we concerned if mining activity ceases to grow as it could?
- are there good reasons for believing the new proposals will serve as well as the present incentive system?

6.4 In a broad national context, the existing provisions have stimulated the high productivity and growth essential to improving the lot of people. They have also promoted better balance as between regions, which in turn has strengthened the economic and political framework of the nation.

6.5 The mining record in the last quarter-century is perhaps the most impressive of any major sector of the Canadian economy. Here are just five key facts about our mineral industries:

- annual rate of growth is double that for the whole economy;

- it is by far the largest contributor to Canada's balance of payments;
- it is the only major goods-producing sector in the economy 100% or better as productive as U.S. industry—the Canadian average is about 70%;
- it has one of the highest average wages, in every region, of any major sector of the Canadian economy; and
- it is largely based outside the centrally located industrial regions of Canada.

6.6 Here are four key factors about Canadian mining in the seventies:

- metal ore reserves are now more difficult and more expensive to find in Canada than in countries like Australia, and are usually lower grade as well;
- Canadian developments are usually in remote areas and have a very high capital cost;
- radical reductions in ocean transportation costs are not matched by reductions in Canadian railway or lakeshipping costs, thus shifting the international competitive balance from Canada; and
- the regions dependent on Canadian mineral industries cannot, because of their lack of a broad industrial base, afford to have mining activity decline.

6.7 Everything points to tougher than ever competition for Canadian minerals. Canada needs every successful economic and regional development policy it can set. Everything about the record points to the conclusion that the mining incentives are just that. It is hard to think of another policy which has so effectively combined high economic efficiency with regional development.

6.8 The present incentives are value-related. They make discoveries more valuable by increasing after-tax earnings and cash flows. The record demonstrates that they have worked well. The onus is on those who think they can improve upon this remarkable record.

6.9 The White Paper suggests its cost-related incentives can achieve the same result more cheaply. The question is whether this is likely to be true. There is only one way to find out for sure, and that is to try and then accept the consequences. If the consequences are unfavourable, however, it will be too late to restore the situation, as interest shifts away from Canada and big developments go forward in other parts of the world.

6.10 Persistence in time and money is, to a far greater degree than usual, the prerequisite to ultimate mining success. In mining the investment per dollar of sales is astronomical in comparison with most other industries. These are two good reasons to believe that the rare character of mineral discovery coupled with the rapidly escalating costs of discovery is such that the size of the "win" (which would be substantially reduced by the White Paper) is of vital importance to the mining investment climate.

6.11 This climate of a "big win" for success is far more powerful in encouraging exploration in Canada than the proposed weak exploration incentive. This is crucial, because without exploration there can be no new discoveries, and without discoveries, no new mines.

6.12 These facts argue for continuance of the basic features of the present value-related incentives in principle. But more than this, the dollar value of the incentives must also be maintained. If the estimates of the Province of Ontario are close, an annual drop of nearly 200 million dollars in the earnings of mineral companies through additional taxes will have a crushing effect, reducing both cash for exploration and investment, and the ability to raise external debt and equity funds as well. The value of the present incentive provisions is estimated to drop under the White Paper by up to 75% for mining generally and by 85% for iron ore mining to feed the Canadian steel industry.

6.13 It is not only a question of performance, it is also a question of fairness. The provinces impose a heavy mining tax which, combined with the White Paper changes, could make mining more heavily taxed than other industry. The corporation tax is not always fair but the present mining provisions make it more rather than less fair.

6.14 A principle of the White Paper is that taxes not paid by one taxpayer must be made up by the remaining taxpayers. We do not agree that this should necessarily be the case, particularly where the result of tax reduction is to promote high productivity industry which expands the tax base. But if it is a principle it has equal application to the tariff, the annual cost of which is now estimated at some eight billion dollars. It is difficult to justify the White Paper assertion of overly generous treatment of the mineral industries in the face of the annual cost of the tariff.

6.15 In summary, the effectiveness of the existing provisions in achieving a top economic record for Canada, and fairness in balancing of government policies between industries and regions, dictate continuance of the provisions in their present form and amount.

7 Conclusion

7.1 We have discerned six main elements of the White Paper approach to tax reform, and have attempted to assess the proposals from each of these points of view. Our conclusion is that the White Paper scores well on its social objectives, as far as they go, less than a pass on the equity aspects and fails badly on four counts—its structural proposals, its contribution to national objectives, the sheer quantity of the proposed changes and the revenue implications.

7.2 In arriving at this conclusion, we have necessarily levelled a number of serious and damaging charges at several important features of the White Paper approach. If these charges have been sustained by the reasoning advanced, the Proposals will require major, not merely cosmetic surgery. At the same time, the tax reform patient need not die.

7.3 We are concerned by the apparent lack of understanding of the role of private capital in Canadian hands for the advancement of Canada and the well-being of its people. In this connection, the most damaging feature of the White Paper approach is its equation of so-called capital gains with income. If this misconception persists, it will be extremely difficult to avoid tax reform which will result in lasting damage to Canada's economy and society. We have sought to demonstrate the fallacy of this equation, and to set out the tough criteria which will have to be met if any proposal to tax capital gains is not to be self-defeating in terms of real benefit to people, by retarding growth and Canadian ownership.

7.4 We are satisfied that the problems of corporations and their shareholders under the present Act do not require a radical new tax structure. Our conclusion would not change if a capital gains tax were introduced, as we feel any such tax must be separated from the income tax as being a different type of tax—namely, a tax on capital, more like gift or estate taxation, although computed by reference to only a portion of total capital.

7.5 Canada in the seventies faces two separate but closely linked economic challenges. The first is to continue and accelerate the development of every part of Canada, with as much of this development as possible in Canadian hands. This effort will continue to require significant imports from outside Canada of capital, enterprise, technology and people skills. The second is to get more deeply involved than ever in world economic development, by exporting our own capital, enterprise, technology and people skills and equally important by making Canada an attractive base from which the capital, enterprise, technology and people skills of non-residents can be deployed for both North American and world business and financial activity. The White Paper approach of international tax discrimination and unilateral deviance from accepted norms of international tax harmonization is retrograde, and will severely limit Canada's ability not only to develop Canada but also to achieve the effective and profitable role it could otherwise play in fast changing world economic developments.

7.6 Canadian ownership will not be advanced by any of the provisions of the White Paper. It will be retarded by many—especially by the adverse savings effects of the capital gains tax and the elimination of recognition of small business financing problems, and by the negative proposals for mining and Canadian based international investment.

7.7 Tax reform of the size and divisive dimensions of the White Paper in its present form would require a continuing over-commitment of resources to a policy area that at the very best cannot mean enough real benefits to people to warrant the risks and efforts involved. The result of over-ambition could very easily become severe breakdown with serious loss rather than gain. It would be a Pyrrhic victory indeed if the tax technocrats got the tax structure they want while we lost the Canada we want.

7.8 The task of maintaining Canada now clearly depends in large measure on attracting capital and enterprise to every part of Canada

on a basis where it will be productive enough to provide good jobs and incomes. It would be a mistake to think we can get big increases of capital investment in the places where it is needed most, if the general climate for capital in Canada worsens. Ironically, it is capital for the high productivity mineral industries with their broad regional spread, where the White Paper impact will be sharpest.

7.9 Canada has always been an incentive society. Hard work and successful effort have always been rewarded. The tax system, taken as a whole, has not borne too heavily on initiative. And all this has been accompanied by substantial improvements in the well-being of almost all Canadians. The success of some has worked to the benefit of all. That there is more to do is unquestioned. That the accomplishment of this now depends on governments to a greater degree than on individuals is seriously questioned. For the day the goals of the state take precedence over the goals of individuals and their ability to achieve them is the day we will have a very different Canada from anything any of us have ever known.

7.10 Many aspects of modern life sap initiative. Sheer size and complexity give many people the feeling that they cannot shape their own destiny. Public policy should strengthen initiative by strengthening the incentives which help people feel they can make something of their own lives through creative effort. It will take more than the tax system to achieve this—but it is essential that the tax system not weaken incentives. Getting ahead on the basis of good performance is still a worthy goal. Without this goal where would mankind be?

7.11 The thrust of the White Paper does nothing to strengthen the economy or the individual in our society. Our prime tax reform objectives should be to strengthen the economic environment and to strengthen the incentives for people to respond fully to the many challenges of Canada in the seventies.

7.12 Our conclusions for tax reform action are these:

- the desirable social objectives (downgrading the role of Canadian private capital is not one) can be readily and quickly achieved without radical change in the essential framework of the present system.

- the equity aims of reform can only be achieved by
  - eliminating the proposed approach to the taxation of corporations
  - providing for the recognition of inflation in taxation
  - eliminating the proposed discrimination in international investment.

- the closely-held widely-held integration, common top corporate-personal rates, and capital gains as income proposals constitute a structural package which is inherently unstable. It lacks the necessary durability, understandability and flexibility to be implemented and would stimulate a major increase in tax-motivated decisions. The structural package should be abandoned.

- the dividend tax credit, or an equivalent, should be retained which would avoid the treaty risks of substantial revenue losses, together with tax-free inter-corporate dividends.

- the weight of Canada's economic requirements makes a capital gains tax undesirable on balance. But if there is to be one, a completely new plan to that proposed is required, based on the fact that capital as a source of future income is not the same as current income.

- the proposals must be revised to retain and preferably to improve the volume of private savings in Canadian hands. Canada needs a national savings policy for the seventies. Canada also needs to broaden its economic democracy. Tax reform should help rather than hinder by including:
  - an adequate tax concession to finance new and growing smaller business
  - continuance of the present incentives to the highly productive and regional development oriented mineral industries
  - a very different capital gains—estate tax mix
  - a savings incentive geared to the low and middle income earners.

- **the restrictive and discriminatory international proposals must be abandoned so that Canada can advance as a base for international business and financial activity.**
- **there must be a clear rejection of the thrust of the White Paper to preempt an ever increasing share of the national income for the federal government.**

7.13 These conclusions are based on the realities of Canada and the ambitions of its people. They will strengthen the economic environment and provide incentive for Canadians to build for themselves and the future of Canada.

APPENDIX "D"

BRIEF OF LORAM LTD.
ON THE WHITE PAPER
PROPOSALS FOR TAX REFORM

BRIEF OF LORAM LTD. ON THE WHITE PAPER PROPOSALS FOR TAX REFORM

SUMMARY

A. Perspective from which the proposals should be examined

Prosperity and development of Canada and all Canadians requires economic growth. The two main ways in which growth can be achieved are through the maximization of profits, hence the creation of new capital and through the maximization of the generation and use of talents. Profits are the costs of the future and business is able to create capital through the maximization of profits more readily than governments because:

1. No government has been able to demonstrate that the public sector can invest more efficiently than the private sector.

2. Governments have no yardstick with which to measure performance.

3. Governments are unable to change and adapt to change (they cannot abandon uneconomic activities).

4. Governments are not innovative.

5. The public would not be allowed to maximize the use of its talents.

6. Government costs must be higher due to the fact that every dollar must be accounted for.

7. Governments are not geared to taking risks.

Growth requires mobilization and maximized use of the talents in the whole country. We must encourage people to take risks to increase their talents, to stay and provide a prosperous growing and viable economy. We should promote repatriation and importation of talents where we are lacking.

B. A Critique on the White Paper Proposals

1. The proposal to tax capital gains will inhibit growth because it will restrict the creation of new capital and will discourage

the maximization of the use of talent due to increased risks.

2. Integration of corporate and personal incomes will inhibit growth because it will discourage the retention of profits for expansion.

3. The development of the country's natural resources will be discouraged through the elimination of the three year exemption for new mines and through the fact that the benefits of depletion allowance will disappear on forced distribution.

4. Entertainment expenses are a necessary cost of doing business and any abuses are subject to attack under the present legislation.

5. Changes in depreciation provisions, if any, should be included in the proposals, but recognition should be taken of the necessity for incentives by means of special rates which will encourage development.

6. Provision should be made for the filing of consolidated income tax returns.

7. The averaging proposals are not sufficiently generous and should apply to taxpayers whose incomes are on the decrease as well as those whose incomes are on the increase.

8. Innovation, experimentation and research should be encouraged through special tax incentives.

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Two of the highest objectives in Canada today are prosperity and development. Prosperity and development of a country are no panacea, indeed, they are very dangerous. They mean growth and growth is never orderly, it is also a change and change in society and culture is dislocation. The period in which a society takes off on sustained development is a most dangerous time. Economically speaking as development starts to become a success it becomes an accomplished fact. However, the leaders still think in terms of traditional society rather than respond to the new reality. At this moment there is grave danger of a social and political catastrophe, Quebec separatism is an example of this - if no growth occurs Quebec will be a depressed area, and therefore more political, social and economic unrest will result. Development is risky but the alternative is infinitely more risky. At least we can direct, lead, control and inspire development. The alternate we can barely even hope to survive; just as Canada as a Nation wouldn't survive the separation of Quebec. Economic development is the central economic task of this age and for Canada the tie that will hold the country together. So far we have misunderstood it, we have believed that the task is to make the poor wealthy.

Development Required For Growth

One of the basic assumptions of the White Paper is that the wealth of the rich should be distributed amongst the poor. John Pincus of the Rand Corporation has computed that in order to tackle the world poverty problem through distributing the wealth of the rich nations, to raise the per capita income throughout the world to $1,000 per year (still less than 1/3 the U.S. figure) would require 1.4 thousand billion dollars a year. That is more than the total annual income of all the developed countries. It is almost 200 times as much as the U.S. spent on aid in any one year. Even to raise the income of the poor nations to that of the rich among them i.e. Northern Spain, Formosa or Chile you would have to distribute each year, more than the total U.S. national income. Distributing wealth may be good social justice but it has always been absurd economics. Aid can only be a stimulant, the main growth must come out of the resources of the poor areas themselves. Effective aid acts as a catalyst releasing local energies, but aid unless carefully planned and ruthlessly administered may also tend to inhibit the energies of the recipient rather than release them - this has become apparent in many areas of our aid to depressed areas, which so very well intentioned, is actually causing development failure. We therefore must not inhibit the use of our own resources and when we develop an aid program to a depressed area it should be designed to create incentive. The test for aid to poor areas of the country is therefore whether it makes the poor area capable of being productive - if it fails to do so it is likely to make those areas poorer still in the not so very

Distribution of wealth is only effective if it causes poor areas to become productive

* University of Columbia's Journal of World Business - Fall, 1967.

long run. To be sure, development requires substantial amounts of money in investment, but to succeed, these must come as support to effect the existing productive efforts of a going Community. No matter how serious a problem an area is we cannot afford to waste exceedingly scarce resources - help in such a case only makes things worse, but we also need to be able to go to work where in spite of the projections of the Economists development is none the less happening. The choice is between wasting aid, resources, and investment and obtaining real development and growth. What we need most is the continued development of highly viable areas so that growth will continue to be self generating.

Present assumption of economic theory no longer tenable.

We must evaluate the effects of the new economics with which we are attempting to run the country with respect to the basic assumptions of economic theory. There are several assumtpions underlying economics today that are no longer tenable. The fact that most modern Economists make them subconsciously makes it all the more troublesome that these assumptions of economic theory is that of economic equilibrium. Economic theory assumes that the goal of economic policy is a balance. Full employment is such an equilibrium - it sees growth as needed only insofar as the labour force increases with the growing population. We have since learned that a stable equilibrium is not possible in economics. The only thing that can give full employment is dynamic dis-equilibrium. An economy is like a bicycle - it only has balance when it is moving. The forces of growth are always unbalanced - yet only a growing economy can be self generating and attain a type of equilibrium, but economic growth is hardly known to economic theory least of all to the "new economics". If growth is admitted at all it is treated as a disturbance outside the system. Prevailing economic theory is based on the assumption that an economy oscillates around the same perfect balance, a balance in which there is neither inflation nor deflation, neither unemployment nor labour shortage nor idle capital or boom - the assumption is an economy that is briskly standing still. Qualitative structural change has its growth. Its dynamics are as much beyond the ken of economics today as motion was beyond the capacity of mathematics before differential calculus. The crucial fact of modern economic life, indeed, the great economic change of the two Centuries since the industrial revolution, is that productivity is the central variable and its increase the test of economic theory and economic policy. An example of the absurdity of economics today in relation to the real central problem of economic growth is that our most sophisticated economic model today, the input - output model of the whole national economy, cannot embrace any change in productivity at all. All it can do is work out the consequences of an increase or decrease in production provided the

In-put - Output economic model cannot embrace economic growth

technology and productivity remained unchanged. It cannot predict how productivity change in a given industry or given economic sector will affect the rest of the economy or any other sector. It cannot show what would happen or would have to happen for such productivity changes to occur or at least become possible. This is not because we lack data but it is the result of basic assumption underlying the model itself. Growth is a necessary goal of a modern economy, its absence in the poor countries and poorer areas is our greatest economic danger. The Economists know this as well as anyone else and the best among them spend a great deal of their time on growth problems. Since, however, their own models exclude growth they grope in the dark and everything that pertains to growth, try this and try that, and go by fads rather than knowledge.

Professor Walt Rostow developed in his book "The State of Economic Growth, 1960", the first recognition by a prominent Economist the concept that we need a systematic theory on Economic Growth and the first attempt to apply to growth the tools of economic analysis, but his underlying assumption that a high rate of savings by itself both explains and produces growth has not been found valid. Absence of adequate savings makes growth impossible but even abundant capital investment may produce no growth at all. Indeed, capital formation and capital investment may well be the result of growth rather than, as Rostow postulated, its prerequisite. One 20th Century Economist the late, Joseph Schumpeter, first of Austria and then of Harvard, pointed all this out 60 years ago before World War I. He also developed the first approach to theory of economic growth. He identified innovation as the cause of economic growth and the entrepreneur its agent, but since then almost no work has been done in the field.

Innovation is the cause of economic growth.

World War I ushered in the one period of economic continuity extending through World War II. During this period, maintenance rather than growth was the central concern. This is, of course, the theme of Keynes' economics, which, in turn, was a re-formulation of equilibrium economics and a badly needed one, by Keynes' formulation was not the growth theory we need nor was it intended as such. Indeed, in Keynes' economics there is a conflict in maintaining what we have and what goes beyond it, that is growth. If economic theory cannot overcome this conflict it cannot overcome economic crisis. It is quite clear, to repeat, that we can only maintain equilibrium through a policy of growth. An economy that stands still however briskly is an economy in decline, as the British example of the last 20 years has shown.

Policy of growth needed to maintain equilibrium.

A cynic may well come to the conclusion that economic performance so far in the western countries has been adversely proportionate

to the number and prominence of Economists in government service. The cynic may conclude that the more Economists and the more attention paid to them, the worse the economy performs. Japan and Germany which have grown best have few Economists within the government.

Economic growth is not related to numbers of Economists.

There are two very famous names in the business world of Japan (the Founding Fathers in fact of the modern Japanese Economic State), Iwaski and Shibusawa. For 20 years these two men engaged in public debate. "Maximize profits" said Iwaski. "Maximize talents" said Shibusawa. Today we know that both were right for development. We have to multiply productivity of capital. We have to attract the available capital of the economy into growth opportunities but for development we also have to multiply human resources. We have to attract the human energies of society into growth opportunities. Wherever we have disregarded these lessons we have failed to generate development. Both Iwaski and Shibusawa worked for a strong and achieving Japan rather than for a rich Japan. Both men knew that the essence of development is not to make the poor wealthy - it is make the poor productive. For this, one needs to make productivity the fundamental resource and objective. One needs to multiply talent and capital. Japan accomplished development Iwaski's way by attracting and mobilizing every penny of capital within the country. As a result, a shortage of capital never impeded Japan's development so she did not borrow abroad or depend on foreign investors. We have to also take a page of Japan's book and attract and mobilize every penny of capital within this country. To that end our economic objectives should be geared. Japan also walked Shibusawa's way and attracted, trained and mobilized every ounce of human energy. She put to work on growth opportunities all the talent the gifted people could muster. If Iwaski's venture banking gave to Japan the highest rate of monetary capital formation ever recorded Shibusawa's stress on the human energy gave Japan within 30 years the highest rates of human capital formation and literacy ever recorded. The two men differed only in their emphasis - Iwaski could not have succeeded had he not known how to develop and find large numbers of brilliant young men whom he formed into a world wide management team of the highest esprit de corps and competence and Shibusawa's command post was the Dai-Ichi Bank which he built into one of the major financial institutions of the country.

Growth requires maximization of profits and talents.

The economics of development and growth rest on the twin pillars of developing people and multiplying capital. To get development and growth both have to be organized and there must be concentration on both. In brief, we need to organize the contract growing of money and the contract growing of people.

What is lacking is effective demand and reward for utilization of capital and talents. What is needed is systematic organized multiplication of capital resources and their employment on development opportunities. Capital without people is sterile whereas people can move mountains with minimum amounts of capital well motivated and in a climate that promotes its use. Development, therefore, requires rapid growth of human talents and their employment on opportunities and incentives for people to create capital by deferring present enjoyment and using capital to create maximum growth. Talents working with capital gives growth and prosperity and a better living for all.

Incentives required to maximize talent.

Growth requires mobilization and maximized use of the talents in the whole country be this in terms of straight labour, technical expertise, management ability or generation of theory. In order to attain maximized use and development of talents there has to be incentive and the best incentive lies in economics and the ability to increase economic positions. We must encourage people to take risks to increase their talents as generally to increase talent entails an opportunity cost. We have to encourage our people to stay and provide a prosperous growing viable economy which promises growth and opportunities, growth and challenge and growth and economic rewards. Further, we should promote the repatriation of and the importation of talents into Canada in fields in which we are lacking. However, it should be as a matter of Government policy where Canada has the talents, that Canadian talent should be used. To not utilize fully the talents that are available to us is a triple penalty. Firstly, because we pay a cost of supporting the unused talent, secondly, because we pay a higher cost where there is a shortage of the talent and thirdly, because we cut-off growth in the multiplyer effect. An example of this is the immobility of labour. The Maritimes have a higher rate of unemployed and consequently high welfare and unemployment cost whereas Ontario has a shortage of labour resulting in a high rate of inflation and a higher cost for the same services. To encompass growth the theory that we will have to develop will first require that economics become teleological. That is, it starts out with a goal in the future and works back to the present. Historically economic theory has started out with the present arrangement of forces and projected from it. This assumes that the structure of the future is identical to the structure of the present, there is no room in such a projection for true change such as genuine innovation brings about. It can only admit a better allocation of already existing resources of all kinds, including the resource of knowledge. The theory we need must start with the postulate that the theme of economic policy is genuine change in the wealth producing capacity of the economic

resources rather than their re-arrangement. It will have to start out in words with the postulate of innovation. This must shift the focus of economic theory from cost, where it has always been, to risk. This in turn leads to the re-evaluation of the nature, role and function of profit.

Profit fulfils a vital and irreplaceable economic function and profitability is the one reliable economic yardstick of investment decisions. Risk rather than cost becomes crucial. Market test rather than efficiency determines success. The more nearly therefore an industry optimizes profit the more it will contribute to national income and economic growth.

Success determined by market test

In traditional economics profit serves at best a marginal economic function. It is the measurement of the allocation of capital resources. If we assume no growth, profit is not even particularly important in this role. Then we arrive, as the classical economists have, at a pseudo-psychological explanation for the existence of profits, though no psychologists have ever been able to find the so-called profit motive in nature. Profit in all traditional economics in other words is a moral rather than an economic strategy category and the attitude towards profit is idealogical rather than economic. In traditional economics the only risk is lack of information about the past and present and the aim of economic policy is to minimize risk. But the moment we assume growth, we assume uncertainty, that is, we assume that present resources are committed to genuine risk because they are committed to making a different and unknowable future. Thus the purpose of economic policy in a growth economy must be to enable the economy to take bigger but better risks. In growth economics, therefore, profit becomes the cost of uncertainty, it is no longer surplus. Indeed we can formulate as a law of economic development that there is no profit at all excepting only such profit as results from politically imposed monopoly which, of course, is "tribute" rather than profit. There are only costs of the future, they cannot yet be measured but they are as real, as tangible and as certain as the costs of the past that our accounts record. Just as we asked with respect to the accounts of the past whether there is enough revenue to cover them, we must ask with respect to the costs of the future whether there is enough revenue to cover them. The central question in respect of profits is whether they are high enough to allow the economy to take the risks needed in order to grow. This holds true whether we stress capital accumulation or consumption in our theories of economic equilibrium, that is, regardless of the position we take with respect with the economics of today and yesterday. This view eliminates the profit motive, it also eliminates profit as a capitalist rakeoff. What they have done,

In growth economics, profit is the cost of uncertainty.

and rightly so, is realize that profit is needed for an expanding economy regardless of political beliefs or economic structure. When we say that profits do not exist but that what we call profits are simply costs of the future that we cannot yet allocate. It is clear that we need revenue to cover the risks of investing in growth. These revenues can only come out of current production, just as the revenues to cover the costs of doing business to-day, the accountant's costs can only come out of current production. Current production is the only thing in the economy we can dispose of, it is the only present, the rest is either memory or expectation. It is also reasonably clear that we must some how get these revenues into the right risk, that they must be used to make the future rather than to defend the past. This argues for a strong capital market. The minute, however, that we put growth into a model, profit and its meaning change entirely. The answer to the cry "exploitation" is no longer to get rid of the exploiters but to create growth in productivity. The answer is to make the poor productive and this requires risk, uncertainty and profit.

Business can adapt to change and can abandon unsuccessful activity, Governments cannot.

Business is particularly appropriate for growth because it is predominately an organ of innovation. Of all social institutions, it is the only one created for the express purpose of making and managing change. All other institutions were originally created to prevent or at least to slow down change, they become innovators only by necessity and most reluctantly. Specifically, privately owned business has two advantages where government owned business has major weaknesses. Business can abandon an unsuccessful activity, indeed it is forced to do so if it operates in a market and even more if it depends on a market for its supply of capital. There is a point beyond which even the most stubborn business man cannot argue with the market test no matter how rich he himself may be. Even Henry Ford had to abandon the Model T when it no longer could be sold, even his Grandson had to abandon the Edsel. Which is more, of all institutions, business is the only one that society will let disappear. It takes a major catastrophe, war, revolution, etc. to allow the disappearance of a university, hospital or government arm no matter how superfluous and unproductive they may have been. Precisely because business can make a profit it must run the risk of loss. This risk, in turn, goes back to the second strength of business. Alone, among all institutions, it has a test of performance. No matter how inadequate profitability is, it is a test for all to see. One can argue that this or that obsolete hospital is really needed in the Community, or that it will one day again be needed or one can argue that even the poorest University is better than none. The Alumni or the Community always have a moral duty to save "dear old Siwash". The consumer, however, is unsentimental, it leaves him singularly unmoved to be told he has a duty to buy the product of the

company because it has been around a long time. The consumer always asks, "and what will the product do for me tomorrow?" If the answer is "nothing", he will see its manufacturer disappear without the slightest regret and so will the investor. This is the strength of business as an institution, it is the best reason for keeping it in private ownership. The argument that the capitalist should not be allowed to make profits is a popular one, but the real role of the capitalist is to be expendable. His role is to take risk and to take losses as a result. This role, the private investor, is much better equipped to discharge than the public one. We want privately owned business precisely because we want institutions that can go bankrupt and can disappear. We want at least one institution that from the beginning is adapted to change, one institution to prove its right to survival again and again. This is what business is designed for, precisely because it is designed to make and to manage change. If we want a really strong and effective government, therefore, we should want businesses that are not owned or subsidized by government. We should want businesses in which private investors, motivated by their own self interests - make itself interest strong, and deciding on the basis of their own best judgment, take the risk of failure. The strongest argument for private enterprise is not the function of profit, the strongest argument is the function of loss! Because of the function of loss business is the most adaptable, the most flexible of all institutions. It is the one that has a clear, even though limited, performance test - it is the one that has a yardstick, therefore, it is the one best equipped to manage, for if there is a yardstick for results one can determine the efficiency and adequacy of efforts. One can say in a business that our greatest profits are at a level where we control 95% of the cost rather than where we control 99%. Controlling or auditing the last 4% or 5% necessitated by the trustee nature of the public sector costs us much more than the profits from these marginal activities could ever be. One cannot say we will control only 95% with respect to patient care in a hospital, one cannot say this with respect to instruction in the university and one cannot say this in any government agency; there, one has to guess, to judge and to have opinions. In a business one can measure. Business, therefore, is the most manageable of all these institutions. The one where we are most likely to find the right balance between results and costs of efforts. This is the only institution where control need not be an emotianal or moral issue, where in taking control we discuss results and not values.

The consumer is unsentimental.

Function of loss is strongest argument for private enterprise.

Government costs higher because every dollar must be accounted for.

This then gives the perspective from which we feel we should examine the proposals of the White Paper. The first economic objective is prosperity for all Canadians and in order for the economy to be prosperous it must be growing. Growth requires two things -- that we maximize the creation of capital and that we maximize the

generation and the use of talent. In order to maximize the creation of capital, we must provide and maximize the incentive to take risks and defer present enjoyment. In order to maximize talents for all Canadians we must encourage the general public by giving it incentive to be productive and innovative. We must make the poor productive and self-supporting.

With these points in mind then let us examine the specific proposals of the White Paper.

A. Proposal to Tax Capital Gains

1. Does the proposal to tax capital gains encourage the maximization of the creation of capital?

A tax on capital gains will have the effect of restricting new development because the investor will find that the low-risk investments are more attractive in relationship to anticipated return. Without the incentive to invest in new development, increased productivity will be inhibited and therefore creation of new capital will be restricted.

Since the end of World War II there has been an increasing disincentive to invest capital funds in certain risk ventures because of the inflationary forces. For example, the cost of a D-8 tractor has increased as follows:

1950	$22,000
1960	$53,000
1970	$89,000

To tax the gains resulting from the investment in projects which would utilize this type of equipment would further increase the risk and therefore decrease incentive to invest.

The White Paper not only discourages growth through the reduction of incentives to create capital, but it goes so far as to advocate the confiscation of capital.

(a) The proposal fails to recognize that certain absolute dollar gains are merely the results of inflation and do not represent real or economic gains.

(b) The combined effect of Estate Taxes, Gift Taxes and Capital Gains taxes is to confiscate capital. As an example, when an estate tax becomes exigible, an heir could well be forced to liquidate certain capital assets, thereby, giving rise to capital gains tax and double taxation.

(c) The proposal to tax the proceeds on the sale of goodwill, the cost for which has not been allowed as a deduction (on hand prior to implementation), is also confiscatory. We applaud, however, the Government's proposal to permit a deduction from income of the cost of goodwill acquired after implementation at the rate of 10% per annum.

2. Does the proposal to tax capital gains encourage the maximization of the generation and use of talent?

The lack of new development will have the effect of restricting the maximization of the generation and use of talent. Existing talent will be wasted and in many cases will simply leave the country. In addition talent existing in other countries will be provided with no incentive to enter Canada. The increased risk will cause talented individuals to become somewhat lethargic and satisfied with employment in a static business community, whereas they might otherwise consider the exploitation of their talents by the formation of small business enterprises throughout the country. Talent should be encouraged and developed. This could be accomplished by the use of government programmes (tax deductions or grants) to encourage the movement of people from non-productive areas to those areas of high productivity potential. It is difficult to imagine how the Honourable Minister of Finance was able to rationalize his thinking in such a way as to say in Paragraph 1.10 of the White Paper that ".........taxes should interfere as little as possible with incentive to work and invest.........."

Individuals who possess initiative and confidence in the future may often elect to defer present enjoyment in favor of the greater rewards which may be forthcoming several years hence. Such attitudes should be encouraged and vehicles, such as stock option plans, should not impose a hardship on the individuals but should be recognized as capital transactions, the long term benefits of which should be free of tax.

3. Is the present law adequate and is it being enforced?

In Paragraph 3.10 it is stated that "surplus-stripping" has been encouraged by virtue of the exemption of capital gains. We suggest that this is an invalid argument for two reasons. Firstly, the Supreme Court has recently ruled against taxpayers who attempted the classic form of "strip". Secondly, the introduction of Section 138A into the Income Tax Act 1963, specifically prohibits surplus stripping. This section has never been tried before the courts and we suggest that its enforcement would put an end to Dividend Stripping.

Paragraph 3.11 states that uncertainty exists because of the lack of a clear-cut line between taxable income and tax-exempt capital gains. We suggest that recent court decisions are making the line more clear cut each day. In addition, definitions could be developed by reference to these decisions

and to those of the United Kingdom which would remove a great deal of the ambiguity and these definitions could be enacted as part of the law. We feel that the fact that the Government finds the present legislation and jurisprudence difficult to interpret is no reason for introducing legislation which would remove the problem simply by saying that all gains will henceforth be income.

Paragraph 3.2 implies that all stock market profits and all real estate gains are capital gains. We suggest however, that short term stock market profits are trading profits and are therefore subject to taxation under the present income tax act. Recent decisions of the tax appeal board and the courts make it clear that a large portion of real estate gains are in fact income. We suggest that the gains resulting from stock market and real estate transactions which are of a clearly capital nature should continue to be treated as capital gains and should not be subject to tax. The distinction could be set out in the law as a function of time. (E.G. - if held five years or more, gains would be capital).

4. Alternatives.

While we strongly object to the concept of taxing capital gains, we recognize that the forthcoming legislation may not take recognition of the arguments that we have set out above. Therefore, without implying that our arguments contain weaknesses we should like to recommend certain modifications to proposals in respect of capital gains.

(a) That the proposal to value the shares of widely held companies every five years be deleted and that gains be taxed only upon realization. The inequity of the five year valuation is clearly demonstrated by the case of the small businessman, who, because of the success of his business, decides to expand and use public funds to do so. Upon "going public" he finds that he must reduce his equity position to 50%. Assuming that the success of the business continues, it is reasonable to assume that a capital gains is likely to accrue each year to the individual. If he is required to pay a tax on this accrued gain every five years, he could well be forced into a position of having to sell some of his equity shares in order to pay the tax. He would then lose control of the company which he

created. Therefore, it is predictable that the five year revaluation will inhibit the growth of successful businesses due to the fact that the enterpreneur will be reluctant to go public if such a move endangers the fact of his control. We suggest that there is no such thing as a gain until it has been realized and we therefore strongly object to the five year valuation concept.

(b) Capital gains should be deemed to have been realized at death. However, in order to avoid double taxation cumulative capital gains taxes paid should be available as a credit against estate taxes.

(c) That an allowance for inflation be deductible from the dollar gains in order to determine true economic gains.

(d) That gains realized from the sale of principle residences be exempt from tax.

B. Integration

Do the proposals for integration of income encourage growth through the maximization of the creation of capital?

(a) 2-1/2 Year Dividend Restriction.

The proposal whereby creditable tax can pass to shareholders on distribution of corporate profits only if such distribution is made within 2-1/2 years of the year in which the profits are earned will have the effect of discouraging corporations from re-investing profits into expansion facilities thus restricting the creation of capital and stunting growth. On the assumption that dividends are deemed to be paid on a first in - first out basis, then a corporation which distributes only a portion of its profits each year will eventually reach a point at which no creditable tax will pass with the dividends.

Alternatives

1. One of the arguments used to justify the 2-1/2 year limitation is that the government revenues could well suffer a serious drain in a particular year in which substantial dividends are declared. With the advent of sophisticated computors into the Department of National Revenue it should be a simple matter to determine the amount of undistributed corporate profits at any time and from that data an amount determined as a "reserve" could be appropriated each year out of current revenues. From this reserve all future refunds could be paid. As a result, no time limit would be required.

2. Alternatively dividends could be deemed to be paid on a last in - first out basis. In this manner, the creditable tax would be able to flow to the shareholders each year, if the dividends do not exceed the earnings of the past $2\frac{1}{2}$ years (which is normally the case). This would allow corporations to maintain the established business practice of distributing a portion of its earnings to its shareholders and retaining the balance for expansion without exposing their shareholders to dividends against which no creditable tax would apply.

(b) Creditable Tax.

The present Income Tax Act and Regulations contain provisions which encourage industrial and resource development. For example, Section 83A provides for the write-off of all oil and gas exploration, development and acquisition costs. However, upon distribution of the corporate profits to the shareholders, these incentives will disappear if the White Paper proposals are enacted.

If, for example, an oil and gas company incurs sufficient exploration costs (including acquisition costs) to create a "nil" taxable income, any dividends paid will carry no creditable tax and therefore the shareholders will be required to pay tax at the full rates. This reduced incentive will undoubtedly restrict the development of the country's natural resources thus restricting the means of creating capital.

(c) Pre-implementation corporate surplus.

It is obvious that parent corporations whose subsidiaries have substantial surpluses, will, prior to implementation, cause these subsidiaries to move the surpluses up under the present law which provides that inter-corporate dividends are tax free. Such an action would reduce the funds available within subsidiary companies which might otherwise have been employed to develop increased productivity. This would restrict the size and number of vehicles available for the creation of capital.

The White Paper is not specific as to the rules which will apply to surpluses existing prior to implementation and distributed afterwards. The ambiguities are:

1. It is not clear whether or not all surpluses (including capital surpluses) existing on implementation day are subject to the special 15% tax or whether the rules will apply to Undistributed Income only.

2. The treatment of the "tax paid" surplus as it passes through a chain of corporations has not been clarified.

We recommend that the special tax should apply to Undistributed Income only and that pre-implementation capital surpluses should be distributable tax free. We further recommend that once a surplus has been classified as "tax paid" it should be available to move up through a chain of companies and eventually reach the individual shareholders without any tax incidence other than the 15% originally paid.

C. Resource Industries

1. Do the proposals related to the resource industries encourage the maximization of the creation of capital?

(a) Mining.

The proposal to phase out the three year tax exemption of new mines, will, if accepted, have a great influence on the development of Canada's

mineral resources. Since the bulk of Canada's mineral resources are developed for the purpose of supplying foreign markets, the economic feasibility is predicated on the international price structures of the various products. Many of Canada's existing mines are marginal in terms of rate of return for capital dollars invested and if future developments are to be subjected to a greater tax burden than in the past, this element alone could well price the ventures out of competitive world markets. In addition investors who provide the risk capital that has previously been employed in the development of mineral properties, have been able to look forward to dividends at a reduced rate of tax if the ventures proved to be successful. Since the government's proposals will reduce this element of inducement, the prospects of obtaining the necessary funds will be substantially reduced.

In the case of coal being mined for the purpose of generating electrical power, the removal of the three year exemption will undoubtedly result in increased charges for coal. The proposal that no creditable tax should flow with dividends to shareholders of Utility Companies, will undoubtedly cause the cost to the consumer to rise as well.

These factors will result in a disincentive for the creation of new industry in areas where coal is required for the production of electrical power and will therefore restrict the creation of capital.

It is our recommendation therefore, that the three year exemption for new mines be retained in the Act in its present form.

(b) Depletion

The proposal to eliminate the shareholders depletion allowance combined with the proposal to integrate corporate and personal income taxes has the effect of obviating the depletion allowance granted to oil and gas and mining companies. This is because, on distribution, the creditable tax would be only one-third of the corporate taxable income. The following example demonstrates this inequity.

Oil & Gas Co. Ltd.

	Widely Held	Closely Held
Taxable income before depletion allowance	$300	300
Depletion allowance - 1/3	100	100
	200	200
Tax - 50%	100	100

Shareholder (assume 50% marginal rate)

Dividend income	$200	200
Gross-up	50	100
	250	300
Tax - 50%	125	150
Less - creditable tax	50	100
Personal tax	75	50
Total tax (corporate & personal)	175	150
% of income	58.3%	50%

Any concession to the corporation for risk should also be passed on to the shareholder. This could be partially achieved by granting the shareholder a taxable credit for depletion taken by the corporation. The proposal to withdraw the shareholders' depletion allowance will seriously impair the ability of the industry to raise the large amounts of capital required to find and develop Canada's natural resources. Unless there is some incentive to shareholders of the high risk extractive industries, investment funds will be diverted to mature, stable, tax paying corporations. To develop Canada we must encourage development of its natural resources. Without this development, the formation of the base for the creation of new capital will be restricted.

Past investments by petroleum corporations were made in the expectation of realizing a rate of return based on an effective corporate tax rate of 33-1/3% To propose a 50% rate of tax on these past investments after a short transitional period is retroactive legislation. The present depletion allowance on past investments should be carried forward indefinitely or at least phased out over a longer period than

five years.

2. Do the proposals related to the resource industries encourage the maximization of the generation and use of talent?

   Many of Canada's resources have been developed as a result of the initiatives taken by talented individuals. It is common in Western Canada to see exploration companies formed by small groups of experts (petroleum engineers, gelogists, etc.) and to see these companies grow through the utilization of expertise and capital provided by investors who have been convinced that the ability of these individuals will cause the risk to be minimized. The disappearance of the depletion allowance (on distribution) coupled with the proposal to tax capital gains will substantially reduce the incentive of both the individuals and the investors to enter into such programs. Both of these factors will, therefore, inhibit the maximization of the use of available talents and thus restruct the development of natural resources and the growth of the country as a whole.

D. Entertainment Expenses.

The proposal that entertainment expenses should not be deductible from income is both unfair and unnecessary. It is clear that the intention of such a proposal is essentially to ensure that certain expenses of a personal nature will no longer be available as write-offs (yachts, fishing lodges, etc.). We suggest that the present legislation is sufficiently broad to cover such abuses. In addition, we feel that certain entertainment expense should continue to be allowed since they definitely represent costs of earning income. We recommend, therefore, that no changes be made to the existing legislation in this respect. Japanese and European business men use special personal expense advantages to their more promising people to motivate performance, acceptance of responsibility, and development of talents for the benefit and growth of the business. It is a special carrot for those who perform. The Canadian Income Tax structure should be so geared to give these same incentives so corporations are able to compete for talent on the same basis as our international competitors. Remember corporations don't wantonly incur expenses and any cost or benefit from this type of expenditure is shared with the business and the government for their mutual benefit. Without talent both suffer. In most corporations it is self-policing and will not be abused.

E. Depreciation.

The proposals of the Minister, except for certain specific recommendations, do not dwell on the question of depreciation rates. However, the statement that "......... some have suggested that they (rates) are too generous............" seems to imply that such so-called generosity has resulted in inequities. We should like to point out that in cases where the rates may appear to exceed those necessary in relationship to the useful life of the assets that these rates were purposely introduced as incentives to assist businesses to expand their operations and thereby encourage economic growth. We feel that this method of providing incentives will continue to be one of the most effective means of insuring the economic growth of the country and that the Government should take recognition of this. The fact that the Minister may, by means of amending the regulations, make whatever changes he wishes to the depreciation rates, leaves the taxpayer in a position of uncertainty. We recommend, therefore, that any depreciation changes to be made should be set out as part of the total tax reform but that in any event, the incentive aspect built into the rates should not be eliminated.

F. Consolidated Returns.

The Government has chosen to disregard the Carter proposal that affiliated corporations be permitted to file consolidated income tax returns. The rationale for this decision is that the partnership option will be available to affiliated corporations. However, the rules intended for the partnership option are so restrictive that many affiliated corporations would be unable to comply. For example, a minority shareholder may choose to take up residence in the U. S. A. thereby violating the rule that all shares must be owned by Canadian residents.

There are many situations in which the formation of separate corporations is either desirable or necessary. Some examples are:

1. Limited liability provided each corporation.

2. Separate financing arrangements can be made.

3. Vehicle for the inclusion of minority shareholders in specific ventures.

4. Political expediency.

5. Provide incentive to individuals by delegating responsibility for success of separate entities.

It is our view that a corporation should not be prevented from offsetting the loss of one business against the profits of another merely because of the fact that through the application of generally accepted business practice, separate companies were used to conduct each business. Divide up companies - encourage talent. We recommended therefore, that affiliated corporations be permitted to consolidate their income for tax purposes.

G. Income Averaging.

The proposal whereby a taxpayer may pay a tax at a special rate on the amount by which his income for a year exceeds the average of his income for the previous four years by more than one-third appears overly restrictive. In addition, the averaging provisions apply only when a taxpayer's income is on the increase. An individual is apt to realize a particularly high income in a specific year as a result ofhis application of special talents. To provide the minimal tax relief proposed would be to discourage individuals from exploiting these talents and thus restrict growth. The existing provisions, although not as broad in scope, are more generous than those proposed, as are the provisions in the United States. We recommend that the averaging provisions should not contain the restriction of the one-third excess but that the total amount by which the income of a year exceeds a four year average should be subject to the special rate. We also recommended that the tax payer should have the option of averaging the high year's income with the lower incomes of subsequent years.

H. Innovation, Experimentation and Research.

In order to encourage the development and use of talents, measures are needed which will provide automatic tax relief for those incurring costs in areas of innovation, experimentation and research. Between 1962 and 1966 Section 72A of the Income Tax Act provided for an additional deduction from income of 50% of scientific research costs. It is our opinion that this section should be reinstated and broadened to include innovation and experimentation.

When Section 72A was repealed, the Government introduced in its stead the Industrial Research and Development Incentives Act which provides for grants of 25% of capital expenditures and 25% of eligible current expenditures in excess of the

average of such expenditures incurred in the previous five years. It is felt that these grants are too restrictive in amount and the requirements to obtain approval from the Department of Industry makes the determination of those who benefit arbitrary.

A taxpayer who embarks on a program of research is presently uncertain as to whether or not he may anticipate government participation and this uncertainty inhibits the creation and growth of such programs thereby inhibiting the growth of the entire country.

THE MANNIX GROUP OF COMPANIES

SUMMARY

The Mannix group of companies is primarily concerned with the development of Canada's natural resources. The 1969 total sales or revenue of the group amounted to $85 million. The 1969 payroll was approximately $23.4 million and the average total monthly number of employees was 2,400.

LORAM LTD.

Management Services Company providing most of the common directorate for all associates and subsidiaries.
Head Office - Calgary, Alberta
Annual payroll - $492,000
Number of employees - 30

SUBSIDIARY COMPANIES

Mannix Co. Ltd.

Heavy engineering construction
Head Office - Calgary, Alberta
Since 1958 company has completed an annual construction volume equal to approximately 1% of the total volume of Canadian engineering construction
1969 payroll - $13,605,000 (head office and field)
Number of employees - 1,223
Areas of operations - Canada, Northwestern United States and Australia

Mon-Max Services Ltd.

Design, engineering and plant construction for petroleum, gas, chemical and heavy manufacturing industries
Head Office - Calgary, Alberta. Branch Office - Toronto, Ontario
1969 payroll - $1,546,000
Number of employees - 96 (head office and field)
Area of operations - Alberta and Ontario

Lethbridge Concrete Products Ltd.

Concrete block production, sale of aggregate and ready-mix concrete
Head Office - Lethbridge, Alberta
1969 payroll - $250,000
Number of employees - 37

J. L. E. Price & Company Limited

Building construction
Head Office - Montreal, Quebec
1969 payroll - $1,519,000
Number of employees - 210 (head office and field)
Area of operations - Eastern Ontario, Quebec (Montreal area) and Maritime Provinces

Manark Holdings Ltd.

Supply company
Head Office - Vancouver, British Columbia
1969 payroll - $42,000
Number of employees - 5
Area of operations - Western Canada, but also sells products to Mannix Co. Ltd. projects across Canada

ASSOCIATED & AFFILIATED COMPANIES

Alberta Coal Ltd.

Coal production by surface methods and coal exploration
Head Office - Calgary, Alberta
1969 payroll - $1,918,000
Number of employees - 330 (head office and field)
Total coal production - 4.1 million tons or 38% of total Canadian coal production in 1969
Area of operations - Alberta and Saskatchewan

Alberta Concrete Products Co. Ltd.

Ready-mix concrete and contract paving
Head Office - Edmonton, Alberta
1969 payroll - $2,970,000
Number of employees - 356 (head office and field)
Area of operations - Edmonton, Alberta
1969 concrete production - 369,000 cubic yards

Manalta Holdings Ltd.

Ranching and real estate
Head Office - Calgary, Alberta
1969 payroll - $50,000
Number of employees - 9
Ranching operations at Calgary and Medicine Hat, Alberta

Pembina Pipe Line Ltd. (Public Company)

Oil transportation, oil and gas exploration and production

Head Office - Calgary, Alberta with field office at Drayton Valley, Alberta

1969 payroll - $1,004,000

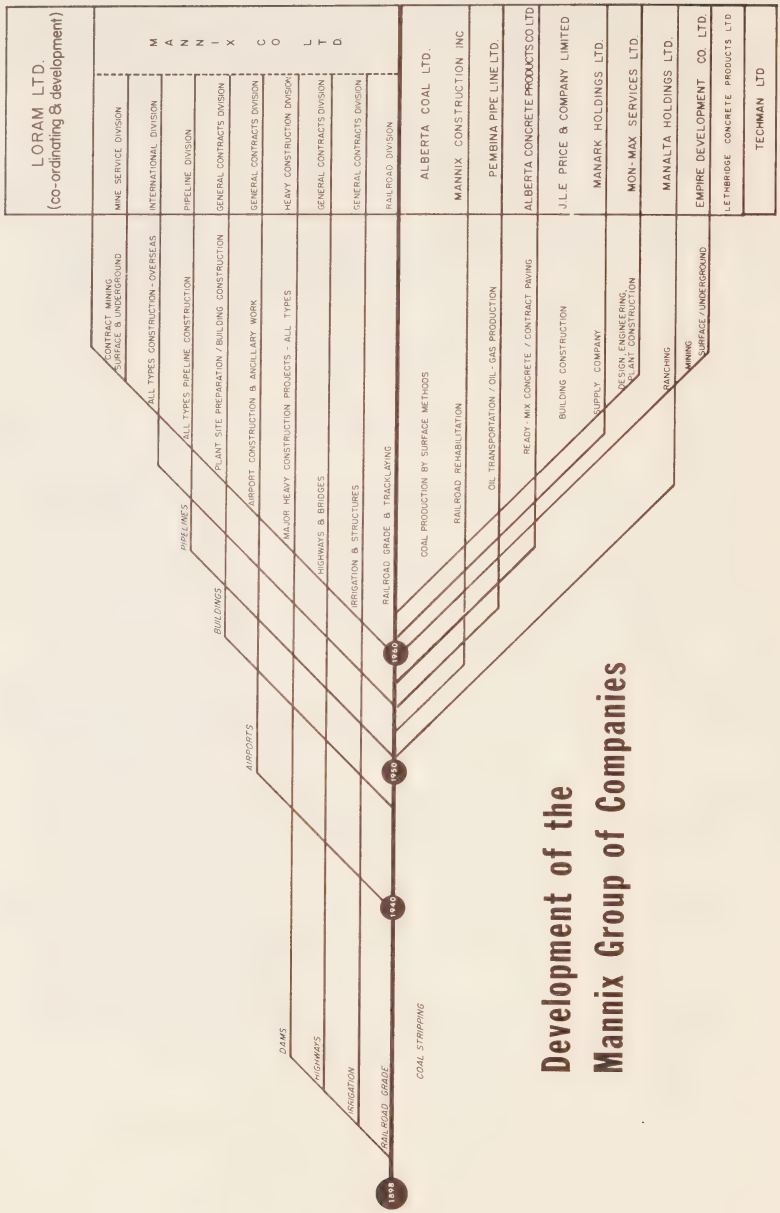
Number of employees - 100

Operating statistics in 1969:

Crude oil transmission throughputs - 130,590 barrels per day

Oil and gas production - 2,990 equivalent daily barrels

Net acreage - 1,418,000 in Alberta, British Columbia, Saskatchewan, MacKenzie Delta, Yukon Territories and Arctic Islands.



Development of the Mannix Group of Companies

APPENDIX "E"

EXHIBITS SUBMITTED

BY

TEXACO CANADA LIMITED

(Referred to in Evidence of Issue No. 31)

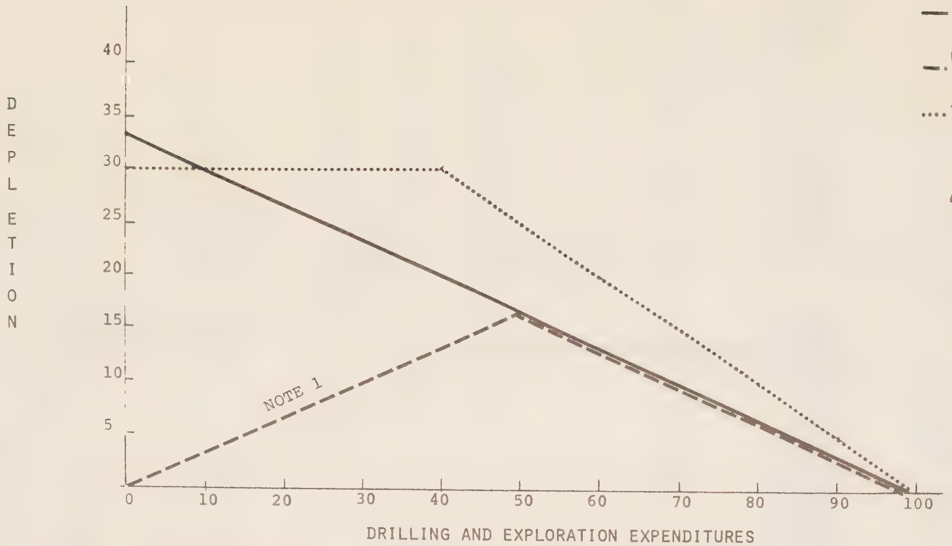
COMPARISON OF DEPLETION ALLOWANCES

EXHIBIT I

ITEM	PRESENT	U.S.	WHITE PAPER	TEXACO PROPOSAL
A. Operator's Depletion	1/3 of net income i.e. after deducting royalty expense, lifting costs, drilling, exploration and bonus costs	22% of gross (after deducting royalty) limited to 50% of net on a property by property basis.	Lesser of: (a) 1/3 of net income, or (b) $1 depletion for each $3 of D.& E.	25% of gross after royalty limited to 50% of net income
Example 1) Gross income $120 2) Lifting $20 3) D&E 40 4) Bonuses 20 80 5) Net Income $ 40	Depletion 1/3 of net income = $13.33	22% of $120 = $26.40 (limited to 50% of net income on property by property basis).	Lesser of: (a) 1/3 of item 5 = $13.33 (b) 1/3 of item 3 = $13.33 Depletion = $13.33	Lesser of: (a) 25% of item 1 = $30.00 (b) 50% of item 5 = $20.00 Depletion = $20.00
B. Royalty Depletion	25% of gross	22% limited to 50% of net as under Operator's Depletion	None	25% of gross (as at present)
C. Shareholder's Depletion	10%-20% of net dividend (depending upon proportion of corporation mineral profits.	None, but individual investor can invest directly and deduct most of his costs from other income.	None	10%-20% as at present

COMPARISON OF DEPLETION ALLOWANCES

EXHIBIT II



—PRESENT SYSTEM

—.WHITE PAPER PROPOSAL

....TEXACO PROPOSAL

ASSUME:

GROSS INCOME	=	120
LESS- LIFTING COSTS	=	20
NET INCOME BEFORE D&E EXPENDITURES	=	100

NOTE 1:- ASSUMES NO PETROLEUM RIGHTS ACQUISITION COSTS (BONUSES)

NOTE 2:- COMPUTATION OF DEPLETION ILLUSTRATED ON EXHIBIT 1

EXHIBIT III

COMPARISON OF EFFECTIVE TAX RATES

APPLICABLE TO OIL AND GAS PRODUCING INCOME

COMPUTED ON VARIOUS DEPLETION BASES

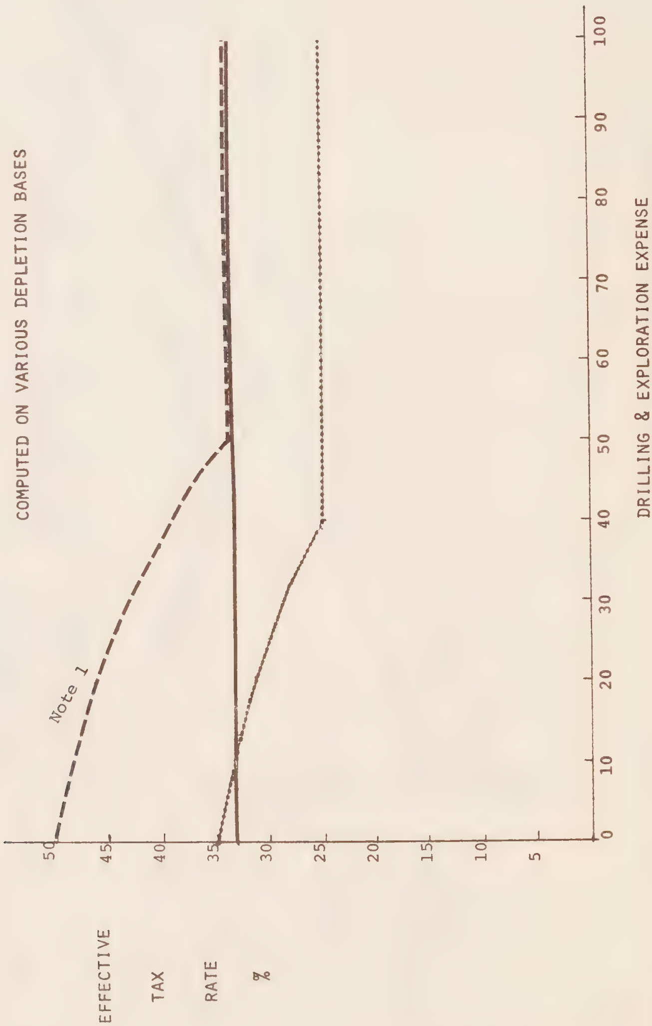
PRESENT SYSTEM

WHITE PAPER PROPOSAL

TEXACO PROPOSAL

ASSUME-

GROSS INCOME	=	120
LESS - LIFTING COSTS	=	20
NET INCOME BEFORE D.& E. EXP.	=	100



NOTE 1:- ASSUMES NO PETROLEUM RIGHTS ACQUISITION COSTS (BONUSES).

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 37

WEDNESDAY, JUNE 24th, 1970

Thirty-First Proceedings on the Government White Paper, entitled:
"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 37: 5)

APPENDICES:

"A"— Brief from The Trust Companies Association of Canada.
"B"— Brief from The Toronto Real Estate Board.
"C"— Brief from the Canadian Institute of Public Real Estate Companies.
"D"—Brief from the Canadian Gas Association.
"E"— Brief from the Canadian Association of Oilwell Drilling Contractors.
"F"— Brief from the National Association of Tobacco and Confectionery Distributors.

22267—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Desruisseaux	Kinley
Aseltine	Everett	Lang
Beaubien	Gélinas	Macnaughton
Benidickson	Giguère	Molson
Blois	Grosart	Phillips (*Rigaud*)
Burchill	Haig	Walker
Carter	Hayden	Welch
Choquette	Hays	White
Connolly (*Ottawa West*)	Hollett	Willis—(30)
Cook	Isnor	
Croll		

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

22267—1½

MINUTES OF PROCEEDINGS

WEDNESDAY, June 24th, 1970.
(60)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Benidickson, Blois, Burchill, Carter, Flynn, Gelinas, Haig, Hollett, Isnor, Macnaughton, Martin, Molson, Phillips (*Rigaud*) and Welch—(17).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

TRUST COMPANIES ASSOCIATION:

Mr. C. F. Harrington, President and Chairman of the Board, The Royal Trust Company;

Mr. J. K. Allison, Expert Group (Montreal Trust);

Mr. F. D. I. Bray, Expert Group (Montreal Trust);

Mr. E. J. Brown, Expert Group (Canada Permanent Trust);

Mr. V. G. Hobbes, Expert Group (Royal Trust);

Mr. D. Lebbell, Expert Group (Royal Trust).

THE TORONTO REAL ESTATE BOARD:

Mr. D. B. Kirkup, Public Relations & Research Director;

Mr. J. Strung, President;

Mr. B. R. B. Magee, Chairman;

Mr. R. J. Dart, Accountant;

Mr. H. H. Strikeman, Counsel.

At 12:00 Noon the Committee adjourned.

AFTERNOON SITTING

2:00 p.m.
(61)

At 2:00 p.m. the Committee *resumed.*

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Benidickson, Blois, Burchill, Carter, Haig, Hays, Hollett, Isnor, Macnaughton and Phillips (*Rigaud*)—(12).

* The Honourable Senator Phillips (*Rigaud*) *Acting Chairman* in the Chair.

Present but not of the Committee: The Honourable Senators Fournier (*Madawaska-Restigouche*), Laird, Prowse and Smith—(4).

WITNESSES:

CANADIAN INSTITUTE OF PUBLIC REAL ESTATE COMPANIES:

Mr. J. Soden, Q.C., President, Trizec Corporation;

Mr. A. Scace, Counsel, of McCarthy and McCarthy, Barristers and Solicitors, Toronto;

Mr. P. Kelly, President, Canadian Interurban Properties.

* The Honourable Senator Hayden (*Chairman*) in the Chair.

THE CANADIAN GAS ASSOCIATION:

Mr. R. G. Wall, Vice-President & Treasurer, (Trans Canada Pipelines Ltd.);

Mr. G. E. Miller, Controller, (Union Gas Company of Canada Ltd.);

Mr. R. Sim, Manager of Taxation, (Trans Canada Pipelines Ltd.);

Mr. M. H. Klein, Counsel, Phillips, Vineberg and Company, Montreal.

CANADIAN ASSOCIATION OF OILWELL DRILLING CONTRACTORS:

Mr. R. E. Sparrow, Director, (President Argus Drilling Ltd.);

Mr. J. D. Porter, Executive Vice-President & General Manager;

Mr. H. J. Irwin, President of Association, (President G. P. Drilling Ltd.);

Mr. A. G. Burton, Advisor to Association (Partner Peat, Marwick & Mitchell);

Mr. G. F. Pearce, Advisor to Association, (President Foster Economic Consultants Canada Ltd.).

NATIONAL ASSOCIATION OF TOBACCO & CONFECTIONERY DISTRIBUTORS:

Mr. E. J. Hartnett, Chairman of the Association;

Mr. J. L. Cunningham, Assistant Director;

Mr. P. Kaiser, C.A., Consultant.

Ordered: That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from The Trust Companies Association of Canada.

B—Brief from The Toronto Real Estate Board.

C—Brief from the Canadian Institute of Public Real Estate Companies.

D—Brief from the Canadian Gas Association.

E—Brief from the Canadian Association of Oilwell Drilling Contractors.

F—Brief from the National Association of Tobacco and Confectionery Distributors.

At 5:25 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, June 24, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have a number of briefs today. The first is that of the Trust Companies Association of Canada. Mr. Harrington will make the opening statement, then the questions may be placed.

Mr. C. F. Harrington, President, The Trust Companies Association of Canada: Mr. Chairman, honourable senators, may I introduce the groups accompanying me: Mr. W. A. Bean, Canada Trust; Mr. F. E. Case, Montreal Trust and Mr. E. H. Heeney, National Trust.

Then my team of experts sitting on my right: Mr. J. K. Allison, Montreal Trust; Mr. F. D. I. Bray, Montreal Trust; Mr. E. J. Brown, Canada Permanent Trust; Mr. V. G. Hobbes, The Royal Trust; Mr. D. Lebbell, The Royal Trust.

From our Association, Mr. E. F. K. Nelson, Executive Director and Mr. J. Sayers, his assistant.

We are very pleased, sir, to have the opportunity of appearing before you today to support our brief on the White Paper on Taxation. It is made up of a general section and a series of technical papers. A number of those who worked on it are here with me. With your permission, Mr. Chairman, I will refer specific questions to one or other of these gentlemen.

My opening statement will be quite short, since our brief contains a summary and no doubt has already been analysed by your staff.

Because our Association represents pretty well all the corporate trustees in Canada, you may well be interested in questioning us on the subject of trusts. I might mention that, in response to the invitation contained in the White Paper, representatives of our Association have had conversations with officials of the Department of Finance and we are endeavouring to supply them with any information on trusts which may be useful to them.

In our brief we indicated the possibility of the Association undertaking a study of trusts, the results of which would be given to the Government. Since that section was written it has become evident that such a study is not essential and that we can provide the necessary information in other ways. We have, therefore, decided that it need not be undertaken.

I believe that our brief indicates our basic point on the taxation of trusts, which is that there are many different kinds established for many different purposes and that these cannot and should not be treated alike for tax purposes.

One of the sections of the White Paper which has particularly concerned us is the proposals for the treatment of investment fund trusts. We think that these proposals have been based on some misconceptions. It is our opinion that the taxation of investment fund trusts should continue to be on the existing basis where the conduit principle is employed. The proposals of the White Paper would be particularly damaging where income type funds are involved; that is to say, where the investment is in debt securities, bonds and/or mortgages. It might be helpful to illustrate this by one of my own company's funds with which I am well acquainted. The Royal Trust "A" Fund is invested in mortgages. It has had an excellent reception by the investing public. Many of the participants in the Fund would have difficulty as small investors in buying mortgages directly. The Fund has played an important role, we believe, in supplying mortgage

money for Canadian families. Unfortunately, the proposals of the White Paper would result in a much heavier tax impact on the participant in this type of fund than would be the case if he owned the underlying securities directly. The proposals would have the effect of making the fund completely unattractive. This is true of the variety of income funds maintained by other trust companies.

Before turning to other aspects of the proposals, I should like to quote section 1.05 of our brief.

> There appears to be in Canada a frightening tendency for the total demands of governments on the Gross National Product to increase in percentage and to grow faster than the growth of our national productivity. This process, among other side effects, constantly erodes the private ability to save and discourages the saving process by the difficulties which it imposes. The implications of this continuing trend cause us great uneasiness for the future of our country.

We, of course, welcomed Mr. Benson's recent letter, addressed to the chairmen of the two parliamentary committees, giving assurance that the Government would not use tax reform proposals for the purpose of increasing its revenue. However, the letter does not alter the fact that it is proposed to increase the tax burden of those in the approximately $10,000 to $25,000 annual income range, whose taxes are already heavy, particularly when compared to their American counterparts. This group contains many of those younger people who are doers and savers in our country and who may well find that the attractions of Canada are too expensive to hold them.

One of our principal concerns is the importance of the encouragement of capital accumulation here, for we can see little possibility of our capital needs being reduced in the foreseeable future. Our concern in this regard leads us to the conclusion that a capital gains tax is economically undesirable at this stage of our development, and also that the proposed treatment of non-resident investors who have been important contributors of capital in Canada is unwise. We consider the White Paper's approach to Canadians who become non-residents to be most regrettable.

The proposals for integration of personal and corporate income have been the subject of much debate, and we have found differences of opinion within our own association. However, we find ourselves in agreement that provision should exist to reduce double taxation of that part of corporate income which is distributed by way of dividends. Essentially what we dislike about the integration proposals is their complexity and the uncertainty of their effect. We think that they should be carefully reassessed.

I told you I would try to be brief and I have. That, in effect, is our opening statement.

Senator Phillips (Rigaud): May I suggest, Mr. Chairman, that with the time problem at our disposal today we ask these gentlemen present on this group to start off at least with a discussion of the problems that directly affect them, the ones that Mr. Harrington referred to. Say by way of a start the investment fund problem, which is covered by a special technical paper.

Mr. Harrington: That is a very important question, and I will ask Mr. Jack Hobbes to speak about that.

Senator Phillips (Rigaud): It is found on page 59 of your brief.

Mr. V. G. Hobbes (Expert Group, The Trust Companies Association of Canada): Mr. Chairman, we have compressed our comments on the effects of the proposals on investment funds into 27 paragraphs, but I think I can probably summarize the gist of our arguments in about three or four minutes.

There are altogether 32 investment funds operated by Canadian trust companies. They have assets running to about $1.1 billion to $1.2 billion at the present time. They were organized over the last 12 years, with two main objects in view. One was to make it possible to provide investment management to small investors without the necessity of charging a basic minimum fee, which would be excessive to small accounts. The other reason was that we found that as the number of accounts that were pension funds that we are responsible for built up, there was a scarcity of qualified investment managers. Therefore, one of the first advantages of this particular arrangement of pooling accounts in funds is that we economize on that rather rare talent, which is the ability to manage investments satisfactorily.

These investment funds are, without exception, organized as trusts. Under the law as it now stands, trusts pay no income tax what-

ever, provided their income is fully distributed each year. The trust, in other words, is invisible to the tax gatherer. This means that an individual participant in such a fund is taxed in exactly the same manner as if he owned the share assets directly. If he is a Canadian invidual taxpayer, he is entitled to claim the 20 per cent tax credit on the portion of his income represented by dividends from taxable Canadian corporations. If he is a tax-free entity, a registered retirement savings plan, for example, the income is automatically re-invested on his behalf tax free. If he is a foreign resident, the usual 15 per cent withholding tax is deducted, and so on.

The White Paper proposes to change this very sensible and straightforward arrangement by declaring in paragraph 5.56 that investment funds organized as trusts should henceforth be taxed as though they were incorporated mutual funds. In paragraph 4.61 we find mutual funds arbitrary classified as widely held corporations, despite the fact that they meet none of the specifications laid out in paragraph 4.43. At the end of paragraph 4.61 we find a statement to the effect that mutual fund shareholders are indistinguishable from shareholders of other corporations. For reasons set out in detail in our brief, we believe this to be a totally false premise.

The effects of the proposals are to subject participants in such funds to additional income tax and additional capital gains tax; that is to say, additional to the tax they would pay if they held the assets directly. The amount of the extra tax varies in a haphazard and apparently aimless fashion, depending upon the nature of the assets of the fund and the tax status of the participant, with results that in some cases are often quite weird. For instance, so-called non-taxable participants actually pay a much greater extra tax than taxable participants. A registered retirement savings plan, for instance, will lose 50 per cent of all interest due to them, and one-third of all capital gains realized if they invest for the fund. The foreign holder who is not, except under special circumstances, supposed to pay capital gains tax at all, actually does so at a higher rate than many taxable Canadian participants. Investors who prefer to invest in a fund holding mortgages or Canadian Government bonds are subjected to an extra tax, but not those whose fund is confined to Canadian common stock.

The consequences of the proposals for these funds are, in brief, so difficult to reconcile with the avowed intention of establishing equity between taxpayers and so inconsistent with many of the principles espoused by the White Paper itself, that we can only conclude that they are unforeseen rather than deliberate, the result of trying to force a square peg into a circular pigeon hole. They stem, as I suggested earlier, from an erroneous conception of the nature and purpose of these funds.

There are clear inconsistencies between the treatment of these funds in the proposals and the tendency of the authors of the paper in many other contexts to look through the form and deal with the substance. The recommendations do not block any loopholes, because there are no loopholes to block. There will be no gain to government revenues, because participants will merely withdraw their money from the funds and invest them directly so as to escape the extra tax. Small investors will lose a convenient and economical investment vehicle. Funds designed to provide income will simply be extinguished, with the loss of possibly as much as $100 million a year to the mortgage market. There is, in fact, nothing to be gained and a great deal to be lost if the proposals are applied to the funds in their present form.

At the end of this section of our brief we suggest a simple arrangement by which participants can be taxed on the income of capital gains received from their interest in the funds in a completely equitable manner, and at a substantial savings in administrative costs, both to the fund administration and the Government itself.

We recommend that the tax treatment of these funds remain on the present basis, subject to a requirement that, both income and realized capital gains be distributed at least annually to be taxed where appropriate, in the hands of the recipients. We also recommend that some means be adopted whereby realized losses can also be made available to participants. For instance, it could be done as a write-off against other income with the corresponding write-up in the book cost of the shares of the fund itself or as a loss carried forward by the fund against capital gains realized in later years. Mr. Chairman, that concludes my summary of that section.

Senator Phillips (Rigaud): I would like to put one question. In attempting to appreciate what you have said with respect to investment funds, you have referred to the mutual

funds. I do not think you have dealt in your brief with the subject matter of a mutual fund and I am wondering whether the trust companies would care to do so, so that we can get the significance of the differentiation you are drawing. Are you also suggesting that the proposed treatment of mutual funds in the White Paper is undesirable?

Mr. Harrington: The mutual fund people came themselves and presented their own brief. We have some knowledge of what was in it and I think basically we agreed with what they said. Would you like to fill that in for the senator?

Mr. Hobbes: There are differences in detail due to the fact that there are two types of funds. For instance, most of the trust company funds are priced once a month rather than every year. They are not sold through salesmen and there is no loading charge.

As I mentioned in the introduction of my remarks, the origin of these were primarily to make it possible to handle our own clients. In fact, roughly speaking, about half of the participants of our funds are people who deal with trust companies anyway. In a sense, it is an internal operation.

There are some minor differences there. The reason why we have to say something about mutual funds is because of paragraph 5.56 which says that in future we will be dealing with mutual funds. As Mr. Harrington said, there is no difference in the general line of argument between us and the mutual fund association.

Senator Beaubien: Mr. Hobbes, you suggest that capital losses be deducted against income. Is that based on an assumption that there will be a capital gains tax?

Mr. Hobbes: I guess for the purposes of this section what we have done is to assume the broad principles, for example, that a capital gains tax might go through. We are dealing with the detailed application of the rules for these funds which concern us very much. We feel that the treatment must be equitable and inasmuch as a shareholder holding shares directly and selling at a loss may utilize that loss.

Senator Beaubien: If there is a capital gains tax?

Mr. Hobbes: Yes, if there is a capital gains tax. We think the same privilege would apply to the participant.

The Chairman: Mr. Hobbes, how do you account for the proposals in the White Paper on the basis of the integration proposals being implemented. Is that the reason you would consider this change in the method of taxing trusts?

Mr. Hobbes: I do not think so. It seems to me that this is irrelevant to many other sections. It also seems that the recommendations we made here could be adopted without really much reference to anything else in the proposals.

The Chairman: To switch from the present system to the White Paper proposals, what elements or factor of tax was being missed under the system that is now being followed which they think they are catching up to now?

Mr. Hobbes: I think, sir, that perhaps the explanation of this is that mutual funds are generally organized as corporations.

The Chairman: I was not talking particularly about mutual funds, but about the various types of trust funds you were talking about first.

Mr. Hobbes: This deals with the broader question of the whole trust area. The authors of the White Paper actually expressed that there is some doubt in their own minds about exactly how to treat a trust. This is our feeling too. There is a suspicion about things going on, but they do not know quite what.

The Chairman: What increase in tax do you anticipate there will be if the White Paper proposals are implemented in this regard?

Mr. Hobbes: The increase in tax which I was dealing with is an increase in tax over and above what an individual would pay if he held the shares directly. Right now any participant in a fund who holds shares directly as well as paying the same tax, whichever medium he follows or whether he holds shares indirectly through a pool or directly, his tax position is identical. Our complaint under this proposal is that in some instances he will pay a tax over and above that which he would pay—can I explain how this would happen?

The Chairman: Yes, please explain that.

Mr. Hobbes: Let's take the case Mr. Harrington referred to. A mortgage fund, which is entirely mortgages—this is an interesting example.

Senator Phillips (Rigaud): Do you incorporate your investment funds as a vehicle for servicing individuals? You spoke of shares in the trusts.

Mr. Hobbes: These funds are trusts and are not incorporated.

Senator Phillips (Rigaud): The share in a trust is really not a share in a corporation.

Mr. Hobbes: We speak of it as units of participation. I would like to illustrate. In a mortgage fund which I have in mind, the assets consist entirely of residential mortgages. The participants at the present time get a cash income of about 9 per cent on the value of the units. The income is paid out to them and they pay tax on that 9 per cent as though it were other interest income.

The Chairman: That is with their marginal rate?

Mr. Hobbes: That is right. Under the proposals the interest income received by the fund will be taxed at 50 per cent and the participant, because this fund is a widely-held corporation, will be allowed to recapture half of that in his own tax payment. To boil it down, the net effect is the result which is now 9 per cent taxable and it will drop to the equivalent of $6\frac{3}{4}$ per cent. This means, obviously, that people are going to seek some way of avoiding this by investing directly into other media.

Senator Phillips (Rigaud): This is quite an interesting point. On the proposed integration system the White Paper states that we create a new taxpayer, which has a corporate existence when in fact it is not incorporated. It would be a constitutional question as to whether you could tax a non-existent corporation as if it were a corporation.

The Chairman: Whether you can tax it at a corporate rate, saying you are levying it on an individual because the tax I take it would be on the trustee.

Mr. Hobbes: No, sir.

The Chairman: He is taxed as though he had no other income, whatever that amount would produce in a rate.

Mr. Hobbes: That is the present situation, yes.

The Chairman: So the present system taxes the trustee as an individual if he keeps the money?

Mr. Hobbes: That is correct.

The Chairman: The White Paper would tax the trustees as a corporation. Well, I suppose there have been all kinds of miracles in a lifetime—changing an individual into a company without the benefit of incorporation.

Senator Phillips (Rigaud): What you are saying is that the Canada Corporations Act about which we spoke last night in the Senate might require an amendment, including the existence of a non-existing corporation.

The Chairman: Mr. Hobbes, is there an intermediate course? Do you suggest that we approach this on the basis that the authors of the White Paper require to be educated? I think the answer to that would be yes. Is there any face-saving device that could be employed?

Mr. F. D. I. Bray, Expert Group, The Trust Companies Association of Canada: Perhaps one answer to that is that in the paragraph 5.56, it is said that there is an unfair distinction between mutual funds and incorporated and trusts of this kind, taxwise. They suggest a way to get around this is not to make the incorporated mutual funds like a trust, but to make a trust like a corporation. The easiest solution I believe is along the lines of the Canadian Mutual Funds Association recommendation, to simply reverse that and put the incorporated mutual fund and the trust mutual fund in the same pigeonhole, and apply the same rules as now apply to the trust, to both.

Senator Phillips (Rigaud): That is exactly why I suggested the question be put, in regard to mutual funds, so that we could get it in the proper perspective.

I would like to press an important point that the chairman made. This seems to be so simple to the average person, that the handling of trust funds is by something like an agency for the individual investment. One would think that in fact something has happened to this which would warrant the recommendation in the White Paper. I think the chairman put that question, so apprently there seems to be no clue to the trust companies, as to what prompted the consideration. I am still pressing that point, by the chairman, on that, as to any inequity in the present law or any discrimination against some of the taxpayers, resulting from it.

Mr. Bray: I think there are none, sir. I believe there are no loopholes to be blocked

here, as I said. What we are asking for here is simply the recognition of the conduit principle—which, incidentally, has been largely recognized under the present Income Tax Act with respect to investment companies. There are special tax rules, as you know, which virtually eliminate this double burden of taxation, which would be borne if there were not provision for a special kind of corporation which is an investment company. So the conduit idea, as applied even to incorporated mutual funds, has been really accepted in the law for about twenty years. This is a backward step.

The Chairman: If you implement the White Paper proposals, to what extent would there be a tax increase in sum total as against what is produced now?

Mr. Bray: Sir, as far as his income funds go, they would simply cease to exist. As soon as people discovered that they could hold, let us say, Government bonds directly rather than through a fund, and get one-third more income, they would simply run to the fund, ask for their money back and make a direct investment.

The Chairman: All right. So we wipe out that type of fund. Now take your mortgage fund.

Mr. Bray: The same thing.

The Chairman: It might not be as easy for individuals to operate in their own right. Their contribution may not be enough to secure a mortgage.

Mr. Harrington: They would invest somewhere else.

Mr. Bray: As I pointed out, if they stay with the fund, the implication is that they will earn $6\frac{3}{4}$ per cent. They could certainly better that by going elswhere.

The Chairman: Yes. So the obvious answer is that they would not stay with the fund, whatever else they may do with the money.

Senator Beaubien: The shares in the funds which were listed would of course go down in value to the level of return which, after tax, would return more before tax.

The Chairman: At the moment we were talking about normal...

Senator Beaubien: You were talking about trying to get over that. They are listed and quoted.

The Chairman: Are they units?

Mr. Bray: The price is determined by the asset value, in the same way as any mutual fund.

Senator Beaubien: There are some that are.

Mr. Bray: It is not a quoted price. It is a price determined in the same way as any mutual funds here, by determining the asset value and dividing by the number of units.

The Chairman: Is there a market for these units?

Mr. Bray: They are non-transferrable but an individual can, subject to certain notice requirements—I am speaking of mortgage funds, in particular—have these redeemed at the net asset value at the end of the month. This is typically the case.

The Chairman: That is at the option of the trustee?

Mr. Bray: No, sir, it is at the option of the holder.

The Chairman: If the holder makes the request?

Mr. Bray: Yes, sir.

The Chairman: The holder gets his money back?

Mr. Bray: Yes, sir.

The Chairman: In the mutual fund, how would it work, how is it dealt with now and what is the difference here? Where is the possibility of tax increase?

Mr. Bray: I am not really an expert on mutual fund, as such, but I can give you a brief summary. First of all, a mutual fund will normally have itself classed as an investment company within the meaning of the act, which gives it certain privileges; and to do that it must meet certain requirements such as a percentage of income from dividends, a percentage of income from Canadian sources, and so on. Having met those requirements, it is then subject to tax on its net income of 21 per cent. This excludes dividends from Canadian corporations. All other income is subject to a 21 per cent tax. When it pays dividends to its shareholders, they are permitted to take the 20 per cent dividend tax credit. The net result of this is that any income in the fund, other than dividends from Canadian corporations, suffers a net tax of about 5 per cent, so there is a small tax loss, as things exist at the present time, but

this would be increased quite substantially on income funds, under the White Paper rules.

Senator Gelinas: I want to clarify my mind. If one wishes to hold these in a mortgage fund, the secondary market is handled by the trust company?

Mr. Bray: The position in most of the funds is that the trust company undertakes to see that the fund is maintained sufficiently liquid to redeem the shares.

Senator Gelinas: Up to a point.

Mr. Bray: No, not up to a point. Without limit.

Senator Gelinas: The redemption must be limited in some way?

Mr. Bray: It is limited, I suppose, in the sense that no bank expects everybody to rush in and demand their money back on the same day.

The Chairman: How do you keep it liquid and follow the injunction that you pay out all the income?

Mr. Bray: We keep it liquid. I am speaking of this particular fund that my own company looks after. It has not been a problem, because cash inflow is normally greater than cash outflow. You expect the fund to grow. You also have repayments of mortgages. You also have a reserve of some sort in cash, so that the normal circumstances are simply no problem.

The Chairman: Is there any other question?

Senator Molson: I want to change the subject.

The Chairman: I was going to say to Mr. Harrington, is there any other phase of the White Paper that affects the trust company in a particular way, such as what we have been talking about, that you would like to take next in order?

Mr. Harrington: We have a large and important section on trusts themselves, that was put together by Mr. Brown of the Canadian Permanent Trust Company. It occurred to me that, as there would not be many other groups coming in here talking about these things, we might summarize the highlights of that for you, if that would appeal to you.

The Chairman: That is a good idea.

Mr. E. J. Brown, Expert Group, Trust Companies Association of Canada: That is on page 41. Mr. Chairman, in this section of the brief, our main point has been that we feel that pure trust concepts should not be prejudiced or neutralized by all-embracing tax legislation applicable to trusts and designed and intended simply to block tax avoidance schemes. We are completely satisfied, and we believe that in their submission the Canadian Bar Association was also satisfied, that there is a place and a need for trusteed asset management in our economy. We readily admit that trusts have been used and are being used under the present legislation to create tax avoidance structures; and we appreciate the Government's concern that the trust concept has been bastardized, if I may use that expression, because of that use of the concept.

The Chairman: You mean tax avoidance or tax evasion?

Mr. Brown: Tax avoidance and tax evasion, both. Even so, we feel that a proper co-ordinated research in our industry and with the tax policy unit and the Canadian Bar Association, we feel that ways can be found to eliminate these abuses, if we can use that word.

The Chairman: Let us stop right there. What would they have to do? Let us assume the income tax people wanted to determine whether or not there was an abuse. What would they have to do and, is there a simple approach to determine that?

Mr. Brown: It is simple in its outline and very difficult in its work. I cannot outline what is happening, sir, very much.

We have already had discussions with the Tax Advising Unit, Mr. Brown and a particular section of the Canadian Bar Association, and between the three groups we have outlined a program, one of definition and delineation of the different types of trusts, if you like, right through the pure testamentary trusts to the business trusts. The brief, starting at page 71, suggests in a very elementary way how some of these types of trusts are used.

Now, we will have to go into much more legal detail before we can come to any conclusion as to whether there is any possibility of segregating the types of trusts into different taxable units, if you follow me this far. Beyond that, we would also have to catalogue all the tax avoidance types of trusts there are.

We are really probably indebted to Marshall Cohen who produced in 1964 a paper for the Canadian Tax Foundation which is probably the best thesis on tax avoidance and tax evasion schemes by use of trusts that there is in existence.

Senator Phillips (Rigaud): I am sorry I did not read that more carefully.

Mr. Brown: It has to be the most learned work in the country on this subject, and it has obviously been in the minds of the authors of the White Paper. I have read it about six times now in the last two weeks and I still do not understand it all. It is the most learned paper, and a great deal of the work we will have to do is contained in this thesis.

The Chairman: What is the title?

Mr. Brown: "Income Tax Evasion of Inter-Vivos Trusts" by Marshall Cohen. It is No. 39 of the Canadian tax papers published in July, 1964, by the Canadian Tax Foundation.

The Chairman: Another edition at this time would have quite a run.

Mr. Brown: It probably would.

The Chairman: I am sorry, go ahead.

Mr. Brown: That is the second point, the cataloguing of all the various segments that there are.

The third point is to overcome 5.57, I think it is, in the White Paper referring to accumulations. The Government does seem concerned about the number of accumulated trusts which have increased significantly during the past few years.

Our research of the industry turned up nothing to substantiate that statement, so we went to the Tax Policy Unit to determine if they had anything on it. We were told that in 1966 there were 6,000 accumulating trusts in this country. By 1968 the number of accumulating trusts had grown to 10,000, so that in a five-year period there had been an increase of some 4,000 trusts. The department is able to count these because they are reported on the T-3 returns, and on a straight count there had been an increase during the five-year period of 4,000 accumulating trusts.

As trust men, the number of increases did not surprise me, but it did surprise the Government. Also, the department did not have statistics beyond the year 1968 when, of course, major revisions came in amending the gift tax and estate taxes which made quite a difference to the gifting programs that people normally used. So it could be that from October 22, 1960, onwards there could have been a significant decrease in the use of trusts. We do not know that. There are no statistics available.

The Chairman: There could be an increase in one section.

Mr. Brown: There could be an increase, but they were unable to tell us, for example, of that 4,000 increase, how many were testamentary trusts and how many were *inter vivos* trusts. There could be quite a difference. You could have a large increase of accumulating trusts for persons under 21 in testamentary trusts, which means nothing to the revenue of the country and which is certainly not tax avoidance.

Until we get these broken down and see what the major problems are, it is very difficult to get into definitions.

The last point is the problem of the mean rate of taxing capital gains causing a trustee to face the equitable portion rule between the life tenant and his remainder.

At the present time the White Paper suggests that the capital gain rate will be at the marginal rate of the taxpayer, because in any estate we have two different people.

The life tenant, of course, takes the income and the remainder man takes the capital. It is obviously inequitable to have the remainder man subjected to a tax on capital gains based on a rate which has no relationship to him at all but related to some other person. This presents a rather major problem to us at the moment.

The problem would disappear with a segregated capital gains tax at a flat rate, because the capital gains tax could then be applied directly into the corpus of the trust and have no reference at all to the life tenant.

The Chairman: The chances are that maybe the direction in which the capital gains tax would go, if there is one...

Mr. Brown: That concludes the position at which we are at the moment. If there are any questions...

The Chairman: Have you any suggestions, or have you drafted anything as to a method of how we might deal with this problem?

Mr. Brown: No, sir. We are just formulating our approach. We have had two meetings

with the Tax Policy Unit and one with the Canadian Bar Association, but we are just now starting to get on it.

The Chairman: If we are expected to deal with this in our report, certainly any help we can get from people who have the know-how would be important, and that also depends on how quickly we get it.

Mr. Brown: I would like to be able to promise something soon, but I cannot.

The Chairman: Do you mean that you are going to leave us to our own devices?

Mr. Brown: We are going to make whatever we have available to this committee as fast as we can. We will make it available to you.

The Chairman: Well, even if there is a scheme—I use that in the legal sense—or if you have a plan indicating a way in which it might go, that would be helpful because, remember, we do have to report and we cannot sit here forever hearing people. There is a stage when we must make a report, and this is one of the subjects that we must deal with.

Senator Beaubien: Mr. Chairman, perhaps Mr. Gilmour could keep in touch with Mr. Brown.

Mr. Brown: I would be very happy.

The Chairman: That is an assignment we will give to Mr. Gilmour. I wondered, though, how far advanced you are to be of help to us.

Mr. Brown: Not very far at this stage, Mr. Chairman; not very far advanced.

Mr. Harrington: Getting our paper put together, sir, has presented a very great problem because we do not have a large professional staff. Men are being taken out of their regular working time to help us get this brief written, and this is a very intricate part about which Mr. Brown is talking. We will help you to the best of our ability.

The Chairman: Well, maybe you could put up certain sign posts.

Mr. Brown: Yes, I think we can do that. I think in all fairness that we may say this: it was not until a month ago that we found out that this is what the Government didn't know. It took us that long to find out what they didn't know about trusts, and which they have admitted in the White Paper.

Senator Beaubien: Did you find out quite a lot?

The Chairman: Would you care to enumerate the things you discovered they did not know?

Mr. Brown: They did not realize, Mr. Chairman, that with respect to every deposit of any size of money a trust company is in a trustee relationship. The tax rate they are suggesting in the White Paper would apply to every deposit we have. They thought they were in the same position as deposits in a bank where there is a borrower-prior to relationship with our depositors. That is not true.

The Chairman: No, it is not.

Mr. Brown: I was rather stunned to find out they had not done their homework.

The Chairman: In how many other directions were you stunned?

Mr. Brown: Quite a few.

The Chairman: In relation to this subject?

Mr. Brown: The whole subject of trusts, yes.

The Chairman: Are there any other questions?

Senator Phillips (Rigaud): Yes, Mr. Chairman. I would like to refer to page 53.

The Chairman: Which page?

Senator Phillips (Rigaud): Page 53 of the submission.

The Chairman: Yes.

Senator Phillips (Rigaud): Mr. Chairman, I would like to turn to page 53 of the submission where it says:

> The conduit principle inherent in the Trust concept is valid, per se, and the proposal to treat a Trust as a corporation is ill-conceived and unfounded.

I should like to make a statement on that. I have been a director a trust company for many years and I am on the executive of a major trust to this day and I have never considered that we were regarded as an incidence for tax avoidance or tax evasion and this comes to me, and I say it in all sincerity, as a complete surprise. I find it very difficult to determine where a trust company can be used an an incident for tax avoidance or tax evasion. It is either legal as done or it is

illegal under the law. The trust company acts as an agent for an individual or a group of individuals, or it acts as a form of corporation, and a trust company cannot be anything but a servant of the taxpayers. Now the suggestion that a trust company is an incident for tax avoidance or tax evasion is something that I cannot follow. The creation of the trust itself by the individual or by a corporation may be the subject matter of tax avoidance or tax evasion, but where in God's world the trust company comes in as part of that subject matter, I cannot follow at all.

The Chairman: Well, the avoidance or the evasion...

Senator Phillips (Rigaud): Is the act of the taxpayer.

The Chairman: But the plan of it may occur before he ever goes to see the trust company.

Senator Phillips (Rigaud): If we accept the principle, which we do with investment trust companies—and I shall not include mutual funds because there we are dealing with a capital structure—but if we accept the principle that trusts are the agent for the taxpayer, where in God's world does the trust company come in as an associated instrument for avoidance or evasion? The trustee is merely the custodian of the assets or the administrative agent. As I said a moment ago, it is the act of the taxpayer, and I do not think you would help me very much in this presentation in answering the suggestions in the White Paper that there is something wrong with their setup.

Mr. Brown: I think that would verify for you, Senator, that the trusts that we are talking about as tax avoidance vehicles are not necessarily trustees in a trust company; they are trustees privately.

Mr. Harrington: That is quite a different thing. It is a very big point and a very important point.

Mr. Brown: We like to think there is a morality in our industry which we police.

Senator Phillips (Rigaud): That is another matter. If a tax evader comes to you and says "will you act for me as my agent in putting through a tax avoidance operation or acting under a secret number under which taxable income will not be recorded..."

Mr. Harrington: We know the difference between evasion and avoidance, sir. One is the legitimate use of one's intelligence and the other is something dishonest. But this came up in connection with individuals.

The Chairman: There is another question I would like to ask Mr. brown. If you break down all the trusts in which any trust company may be a trustee, has the department indicated any analysis or have they pointed to anything that they regard as being an improper use of the trusts?

Mr. Brown: They have not done so yet, but they are doing this study now.

The Chairman: Well, it is about time. This report came out last year. You make the allegations first?

Mr. Brown: Yes, that is what they got.

The Chairman: Any other questions on this point?

Mr. Harrington: Well, I think we are all tired of the sound of it, but capital gains is something we must comment on, and I would like to ask Mr. Lebbell and Mr. Allison to deal with it.

Mr. D. Lebbell, Expert Group, The Trust Companies Association of Canada: Mr. Chairman, briefly and horribly somewhat unoriginally, I think that Canada does not need a capital gains tax at this stage of its development. We regret very much that so many people seem to view its imposition as inevitable at this time. Canada is among the family of industrialized western nations but it is at its adolescent stage and I do not think we need a capital gains tax as proposed in the White Paper which is in excess of that in existence in developed industrial nations such as the United Kingdom and the United States, especially when we see South Africa, Australia, and New Zealand and other countries who are competing with us for the world's capital. However, we do recognize at the same time about it based on the necessity to widen the tax base in the name of equity.

The Chairman: Well, is it in the name of equity or is it a case that here is a source of revenue that has not been tapped, and some people are able to operate in that field, but many people are not, and therefore the many who cannot feel that these gains should be tapped as a form of contribution to tax revenue.

Mr. Lebbell: Perhaps it is both. The argument has been put forward that it is in the name of equity, but the existing sources of taxation, income tax and estate tax and even sales tax have been pretty well used up by our taxing authorities and I think you are correct in stating that they are looking for added sources of revenue.

Senator Phillips (Rigaud): Will you be good enough to turn to page 21 of your brief which deals with the capital gains matters and at item under 6, it reads as follows:

> that estate tax be phased out upon the introduction of a capital gains tax if the tax, as we suggest, treats death as a disposal.

Now, with your experience in dealing with the subject matter of jurisdiction as between the provinces and the federal Government, or duplication of estate taxes, how in God's world can you get a phasing-out process without the agreement of the provinces? And I am rather surprised that you have not dealt with this subject matter involving the necessity, if there should be a phasing out, of co-ordination—that it is absolutely essential that there be agreement between the federal Government and the provinces.

Mr. Harrington: Well, there has to be agreement about the whole thing, anyway, hasn't there?

Senator Phillips (Rigaud): I also notice with surprise that you have not emphasized that point you referred to in the White Paper. As I said earlier, the White Paper is conditional upon the marriage and the honeymoon so far seems to be a bore.

The Chairman: Except that Ontario appears now to have said that they are in favour of the phasing out of succession duties in favour of the capital gains tax.

Senator Phillips (Rigaud): But their consent would be required. I am leading up to the point that I have mentioned before that there should be an ear-marking of receipts of capital gains transferred to the provinces conditional upon the treatment by the provinces of the estate tax. I was wondering if the witnesses would like that. Does that make sense, that if you have a capital gains tax and the funds were established in terms of the amount received in a given year, that the transfer to the provinces would be conditional upon the treatment of the estate taxes?

Mr. Harrington: I think that is very workable.

Senator Phillips (Rigaud): It is not a dream child; it is something that could be worked out.

Mr. Harrington: We believe it could be done, yes.

Senator Flynn: The estate tax is a capital gains tax on the heir or legatee, and your suggestion is that we should give it up and establish a capital gains tax on the man who makes the capital gains in the first place. Is that your suggestion?

Mr. Lebbell: Yes, we are proposing this in our alternative proposals. One of the proposals is that there be a deemed disposal on death and that gains be taxed at that time.

Senator Flynn: Would you agree that by this way the taxing authority would be collecting much more than by the present system of estates tax? Many people make capital gains in their lifetime, but leave very little in the way of an estate, having spent it all.

Mr. Lebbell: Combined with the present rate of estate tax they would certainly be paying more, but we are proposing a phase-out of estate tax.

Senator Flynn: You are taxed on money that you spend. I think that on the whole the Government would be able to have a higher income by exchanging the present estates tax for capital gains tax, even at a lower level than the one proposed in the White Paper.

Mr. Lebbell: Yes.

Mr. Harrington: Yes, we would have to agree to that.

Senator Beaubien: If losses were fully deductible...

Mr. Harrington: It could be a help.

Senator Beaubien: There would be a change in the revenue situation.

Senator Flynn: But in an estate the losses are also taken into consideration. You do not tax losses.

Mr. Lebbell: In addition, the Carter Commission recommended under general income averaging that there be averaging at death, and we support that too.

The Chairman: Have you any comment to make on the flat rate of capital gains tax?

Mr. Lebbell: Yes. This is the part of the brief where there was some difference of opinion among our companies, as to whether we should recommend flat capital gains tax or one related to income tax. In point of fact, we ended up by not being firmly committed to either course. Those of us who are in favour of the flat gains tax saw the advantages, particularly for trust administrations as outlined by Mr. Brown. The flat rate also simplifies the predictability of business decisions. This is important: you know what your tax liability is going to be if you pursue a particular course of business action.

The Chairman: And a flat rate would recognize the inherent meaning of capital gains as opposed to income.

Mr. Lebbell: Yes.

The Chairman: Then you are writing a new definition of "income" when you say a capital gain is income.

Mr. Lebbell: That is correct.

The Chairman: We had the Toronto Stock Exchange here yesterday, and on this subject they made a suggestion that there should be a separate tax for capital gains. They suggested a sliding rate, ranging from 15 to 20 to 25 per cent. I think it was based on the amount of the gain. They had studies and figures to show that there would be a profit to the tax revenues as against the method proposed in the White Paper.

Mr. Lebbell: Mr. Chairman, I could not answer your question as to whether there would be a profit or not. Our concern about sliding rates of tax is that the trust industry is very much an administrator. We are very much concerned with people's financial affairs, and there seems to have been a lack of stress on administrative simplicity about the introduction of a capital gains tax. We think it is going to be extremely complex even in its simple form. Therefore, the problem with a sliding rate or the sort of scale which was proposed, I think, by the Institute of Chartered Accountants in their brief before you, is that it tends to be too complex and makes an already complex subject even more so. There will be many problems with valuations and complexities in this area of capital gains tax, and if we have a sliding rate or varying rates the complexities will be added to.

The Chairman: What about the limitations or exemptions on the application of capital gains tax?

Senator Phillips (Rigaud): Mr. Chairman, with your approval could I still deal with the rate before you deal with that?

The Chairman: Yes.

Senator Phillips (Rigaud): Some question has been raised that a flat capital gains tax—say 25 per cent on a special category—would work out adversely in respect of those whose taxable income brings them below the 25 per cent, whose rate in a given tax year brings them below 25 per cent. What do you think of a capital gains tax flat rate at 25 per cent, or whichever percentage is lower having regard to the rate of taxation with regard to normal income?

Mr. Lebbell: I think we should look at the lowest marginal rate under the White proposal for income tax, which is 21.76.

Senator Phillips (Rigaud): Let us just forget the White Paper proposals. If we eliminate integration and so on, and introduce a straight capital gains tax, how do we cover the situation of the taxpayer below 25 per cent taxable income who happens to make a capital gain and we stick him with the 25 per cent tax?

Mr. Lebbell: That problem can be dealt with by providing concessionary retreatment to the taxpayer, permitting him to pay capital gains tax, say, at half his marginal rate, if it is advantageous to him to do so rather than pay at the flat rate. An alternative is to provide more adequate exemptions for gains. A general exemption from all gains to the individual taxpayer up to a certain dollar limit is another means of coping with that particular problem. We have in our brief such a suggestion in connection with death, where we are proposing that there be a general exemption on the first $15,000 of gain.

Senator Phillips (Rigaud): This has not been dealt with too much by taxpayers making their case here, but I think if we have a flat capital gains tax which ends up in a resultant of 25 per cent...

Mr. Harrington: You could say a maximum of 25 per cent. If you said a maximum of 25 per cent, then you could work it.

Senator Phillips (Rigaud): You have to figure out something so that a taxpayer in the

lower bracket does not get stuck in a higher rate of capital gains tax.

Mr. Harrington: It would seem to be very inequitable—since we seem to hear so much about that word.

The Chairman: It seems to me that very simply you could say the rate of the capital gains tax shall be 25 per cent or the marginal rate of the taxpayer, whichever is lower.

Mr. Harrington: Yes, we have thought about that at some point.

Senator Beaubien: That is very much the American system, is it not?

Mr. Harrington: Yes, it is.

The Chairman: There are some other aspects of capital gains. You were talking about on death and the provisions in the White Paper.

Mr. Lebbell: Yes, we are proposing, as we have just mentioned, that there be an exemption, death being treated as disposal and capital gains being considered as realized subject to an exemption that the gains do not exceed a stipulated amount, and we say $15,000. This is similar to the situation in the United Kingdom where I believe there is an exemption of £5,000.

The Chairman: Why should not the capital gains tax on death be a credit against the estate tax?

Senator Molson: Or vice versa?

Mr. Lebbell: We hesitate to associate capital gains tax legislation with estate tax in as much as we are recommending a phase-out of the estate tax.

The Chairman: Even so, when it is phased out the credit disappears, but as long as it is there, it is there.

Mr. Lebbell: Income tax is a debt against the estate. We consider that capital tax should be treated in the same manner.

The Chairman: The White Paper, in order to avoid a collision between estate tax, capital gains tax and death duty, proposes that the capital gains tax be deferred so long as the beneficiary enjoys that benefit.

That may not be very realistic, because the estate may have to dispose of some of the assets in order to pay its obligations. Therefore in those circumstances there would be a collision of taxes and there certainly should be a credit.

Mr. Lebbell: Yes, we would not object to that.

Mr. Harrington: Otherwise there would be a burden of raising money, which practically no estate can possibly manage.

Mr. Brown: The only problem with the credit is that under the present method of estates planning, if I can use that term, most estate taxes will now be deferred for quite some time because of this freedom of transmission to the wife, whether directly or by trust, until she dies.

Therefore it would be a credit for quite a number of years, involving administrative problems.

The Chairman: There is also the problem of capital gains tax applying to a gift. In the event a husband makes a gift of shares to his widow or wife in her lifetime and they increase in value, she has a capital gains problem.

Senator Phillips (Rigaud): It would not be carried forward too much, Mr. Brown, if the husband and wife are approximately the same age. Of course, we could have the case of young wives, where there would be a substantial deferment.

Mr. Brown: The average testamentary trust runs ten years, maybe a little longer.

Senator Phillips (Rigaud): I wish I had known that in 1923.

Mr. Lebbell: To elaborate on that point, we feel that the deferment of gains tax at death, as proposed in the White Paper, would in fact create blocking. You can imagine the situation where a son inherits a business built up from virtually nothing. There would be a tremendous potential capital gains tax passing from one generation to the other.

We feel also that there would be a certain inequity in that there would be forced realization for those estates that were not in a liquid position relative to others. Those are our basic reasons.

The Chairman: What do you suggest by way of change?

Mr. Lebbell: Those problems would be overcome by taxing capital gains at death and phasing out the estate duty. We have also

asked for the abandonment of the proposed five year deemed realization.

The Chairman: Having said that, you do not need to add any word of explanation.

Mr. Lebbell: On the subject of deemed realization generally, though, we feel that there is a certain narrowness in the concept of equity as defined in the White Paper. If there is to be a deemed realization tax, a very wide field will be entered, where a broad outlook on equity is required.

Senator Phillips (Rigaud): Mr. Chairman, I refer to the point that you intended to raise regarding exemptions under the proposed capital gains tax. I would like to put the same question, but somewhat in reverse.

Some of us have been considering the desirability of a capital gains tax applicable only to certain types of capital assets, such as shares in corporations with obviously no distinction between widely-held and that kind of business, real estate whether it be land and/or yield real estate and businesses. When the shares of incorporated companies are sold they are subjected to capital gains tax and this obviously should apply in respect of unincorporated companies.

As I see it, the trust companies, more than any other group in this country, know more about the breakdown of estates between cash, securities, real estate, personal effects, odds and ends, furniture, paintings and all that sort of thing.

There is a feeling that in a young country such as ours, if we are to have a capital gains tax it should be kept down as much as possible and restricted in its application to securities and real estate under the two headings I have mentioned in addition to businesses.

Considering an average estate, in the light of your experience have we left out much in terms of percentage of worth to people represented by items such as clothing and furniture? That would be a pretty fair test of whether the elimination of other categories for capital gains would give undue advantage to a group.

I will crystallize the involved question: if an estate of $100,000 included $5,000 which did not come under the headings of cash, securities, real estate and business, does it not make sense in dealing with that 5 per cent that it should be exempt under a capital gains system?

Mr. J. K. Allison, Expert Group, The Trust Companies Association of Canada: That makes a great deal of sense.

Are you including the home, residential property, under the category of real estate?

Senator Phillips (Rigaud): I would exclude the home. I am excluding farm, homestead and so on.

Mr. Allison: In those circumstances your $5,000 is a little low to include residential real estate.

The average situation quite often involves a piece of residential real estate forming a fairly significant portion of the estate.

However, in the other categories of furniture, stamp and art collections and so forth, your figure is quite realistic. The loss to the revenue in completely eliminating those would be insignificant.

Senator Phillips (Rigaud): Suppose as a matter of equity in relation to your last point we decide not to be too grasping in taxing the homes of people who set up a decent standard of living in raising a family. Apply the same concept to a farmer who has built up through the years a homestead, with the amount of land associated with it. We place the exemption under a different category, just as we give tax incentives to mining.

Would much remain in an estate other than the categories to which I have referred?

Mr. Allison: Very, very little.

Mr. Harrington: There is insurance.

Senator Phillips (Rigaud): Yes, but that would not enter the picture of a capital gains tax.

I am dealing with the subject from the point of view that the clue to the value of the assets exempted, if we proceeded along the lines I am suggesting, is the analysis of estates through the years. This would indicate through the categories that we have included whether we have exempted automatically a significant amount of capital assets.

As I understand your answer it is that we have not.

Mr. Allison: That proposal would not.

The Chairman: When considering two items such as paintings and jewelry, what percentage of a cross-section of estate do they represent?

Mr. Allison: Very, very small. In a very few estates they form a substantial proportion. In the broad range of estates jewelry, paintings and household effects form a very small part of the total estate.

The Chairman: That information should be available in the records of all those who have passed on. There would also be valuations by the provincial authorities.

Mr. Allison: That is correct.

The Chairman: Is there anything else you wish to say in relation to capital gains?

Mr. Allison: I would like to re-emphasize the point that Mr. Brown covered fairly briefly: that is the difficulty which is going to be created for trustees by the proposals to tax capital gains as income. We are dealing and working under documents which were drafted prior to this proposal which either cannot be changed or can only be changed with extreme difficulty. The proposal to tax capital gains as income, where you as trustees are dealing with two different people, is certainly going to present some difficulties and potential hardships.

The Chairman: You wanted to change to another subject, Senator Molson?

Senator Molson: I wanted to go to page 11, Mr. Chairman, if I might be permitted. It deals with the subject we have discussed frequently in committee and that is the contemplated increase in personal exemptions in the White Paper. I notice the trust companies recommend that income tax relief be provided by changes in the rate structure. I wonder if they would develop this. I might say that we have been talking at other times of a tax credit, in agreement with you, not carrying the exemption through to the upper ranges.

Mr. Allison: I think this comment was predicated on the fact of removing some 750,000 taxpayers from the rolls at a cost, according to the statistics, of some $35 million. They made these across-the-board increases in exemptions and they applied both to the top and the bottom. I believe the cost figure for that is something in the area of $1 billion. There had to be all kinds of fooling around of rate structures in order to recoup that $1 billion. There ought to be a simpler way of removing 750,000 taxpayers from the rolls than an-across-the-board increase in exemptions. It can be done by change in the rate structure so that you pay no tax below a certain rate. It can be done by tax credits.

We have not developed any detailed sort of recommendation in this regard, but I think there are plenty of them around.

The Chairman: The simple way would be to say that the $2,800 is non-taxable income. Then some of the departmental advisers were horrified that earlier in our hearings I suggested that there was no need or obligation and no morality involved in not extending the exemptions to the people higher up in the scale. I said that I am sure if you canvassed them they would say to bring the rates down and to waive the increase in the exemption. You run into this answer.

If you read the counter-attack on the inside front page of *Weekend*, which is attached to the Montreal *Star* and the *Telegram*, Mr. Benson directs his attention to another group. That is the group which goes up to about $9,000, where the increased exemption does give them some lower rate of tax. Even if you did allow it in that area and did not increase the exemptions the rest of the way up you would get along with a lower tax rate.

The suggestion I made yesterday in regard to $40 million was to bring your high tax rate of 82 per cent down to 50 per cent, running about $40 million. All you would have to do, I think, is increase the 50 per cent to 55 per cent and you would recover at least $35 million. Just to assume that because you give it to one you have got to do it with every person and create a tax revenue loss of $1 billion is shutting your eyes to a lot of things.

Mr. Allison: I would agree.

Senator Molson: We have the other suggestion which has been tossed in that the ratio between the single and the married taxpayer might be very wholesome. I think that was because of the marked discrepancy between rates in this country and the United States, particularly, but also other countries. Do you have any comments on that?

Mr. Harrington: I do not think we have.

Senator Beaubien: The tax rates on single people are pretty competitive in Canada with the United States, but there is a big difference between the tax rates of married people.

The Chairman: Are there any comments?

Mr. Allison: No.

Senator Carter: Did I understand the witnesses to say that they prefer exemptions to tax credits? Did they express any preferences between a tax credit and an exemption for personal income?

Mr. Allison: Our stand is that the removal of 750,000 taxpayers from the rolls should be accomplished via an adjustment to the rate structure or in the form of a credit rather than through an across-the-board increase in the exemptions.

The Chairman: We come to a question which has been a favourite one of Senator Phillips. All I do is mention it and I am sure he will take over right away. What is your position on integration.

Senator Phillips (Rigaud): We are waiting for your blessing or your curse.

Mr. Lebbell: Perhaps we should look at page 36, paragraph 6.14. We summarize our recommendations which really reflect our view on it.

Mr. Harrington: It is only fair to tell you that this is a compromise paper. We have quite a lot of independent thinkers in our industry.

The Chairman: That is good.

Mr. Lebbell: We have been concerned with the necessity to avoid double taxation of corporate income. As such, we are essentially here proposing the improvement of the existing dividend tax credit system as used at present. We feel that as far as the integration proposals in the White Paper are concerned they are altogether too complex to be workable, creating too many artificial situations, and paper distribution as would be inevitable under the system. We do not think they are particularly practical.

The Chairman: There are many aspects to it.

Mr. Harrington: The recommendations are in paragraph 6.14.

Mr. Lebbell: We therefore recommend:

(1) That the proposed distinction between closely and widely-held corporations be abandoned.

(2) That income flows between Canadian corporations continue to be without tax consequences.

(3) That the proposed rule regarding distribution of profits within a 2 1/2-year period be abandoned.

These seem to be the most critical aspects of the proposals for integration as they stand in the White Paper.

The Chairman: Let us sum this up now. Part of the integration system is the deemed realization. Let us assume that we eliminate that. Another part of it is the $2\frac{1}{2}$ year limitation on your right to enjoy creditable tax in relation to a surplus. Let us assume we eliminate that. Then we eliminate capital gains and the income concept. We then decide that in the extractive industries where certain incentives are provided, that for purposes of calculating creditable tax the incentives should not be used to reduce the tax base and therefore the creditable tax.

Now, when we make all these assumptions that they are no longer there, what is left of integration?

Senator Phillips (Rigaud): Mr. Chairman, might I suggest one other item? Eliminate the distinction between public corporations.

The Chairman: Yes, eliminate the distinction between widely-held and closely-held companies. When you make all these eliminations, what is left to support this integration doctrine?

Mr. Lebbell: Very little.

The Chairman: We did have the suggestion—Senator Phillips (Rigaud) will actually recall it—yesterday from the stock exchange people. They favour the dividend tax credit, and they propose, from studies they have made, which they are furnishing to us, a sliding rate of 15, 20 or 25 per cent, depending on the amount of the dividend income.

They produced figures, or said they had figures which they would produce which would show a plus in tax revenues of $60 million, by doing that, as against a loss which the White Paper projects on integration of $140 million. In other words, they said that you would actually cover about $200 million as against the $140 million which would be lost on integration.

Mr. Lebbell: That could well be, yes.

The Chairman: So it is very difficult to understand why we should propose a new method of dealing with this particular subject and be prepared to accept a loss of tax revenues of $140 million.

Mr. Lebbell: Well, it is indeed. Of course, we are aware of the fact that this is regarded as an out-of-date concept in other parts of the world, and it has generated particular problems in France, I believe.

Senator Phillips (Rigaud): I think nobody could put it more graphically than our Chairman when speaking of the elimination, because it gets us back to the dividend credit system.

A great number of taxpayers who have appeared before us have, of course, damned the integration system, but large numbers, such as yourselves, have damned it with faint praise because it is subject to so many conditions and revisions. It is very difficult for us to come up with even a qualified acceptance because there are so many revisions and conditions which we may or may not be introduced.

Therefore, I want to come back to the assumption, for the purpose of this question, that we do not like the integration system and we are back now to the dividend tax credit system in force. The question I should like to put to you is: some enterprising taxpayers or taxpayer—I forget which, Mr. Chairman—came up with the thought that in lieu of the present 20 per cent or modified rate by way of dividend tax credit that it be allowed as a deduction against income; do you remember?

The Chairman: Yes.

Senator Phillips (Rigaud): I would like to get the view of this important group on that. They may not have considered it and therefore there may not be a consensus on it.

Mr. Lebbell: We do not have that.

Mr. Harrington: We have not worked on that one and therefore I think there would probably be...

Senator Phillips (Rigaud): There could be a reaction to it, though, without binding the trust companies.

Mr. Lebbell: I think we would prefer to see it as a tax credit at the moment.

Senator Phillips (Rigaud): Rather than a deduction from income?

Mr. Harrington: Yes.

Mr. Allison: I would agree with that.

Mr. Harrington: You have got a consensus, sir. The consensus agrees with us.

The Chairman: To what is the consensus agreeing?

Senator Phillips (Rigaud): A dividend tax credit rather than a deduction, that they get it as a deduction from income.

The Chairman: Rather than what the integration proposals contain.

Senator Phillips (Rigaud): That is the other. The question was: is it desirable to have a dividend tax credit as we do now as against a credit by way of a deduction from income, which was raised by some taxpayers.

Senator Burchill: Mr. Chairman, on that point, in your fourth recommendation on page 37 you state:

> 4. that the concept of employing credits to shareholders to reduce or eliminate double taxation be embodied in arrangements that provide simplicity...

You do not go further than that. You do not make any suggestions as to how that can be provided.

Mr. Lebbell: No. We could go through different suggestions. For example, there could be a 30 per cent rate. It could be a 35 per cent dividend tax credit.

The Chairman: You could abandon the integration proposals and you would eliminate a lot of the paper work.

Mr. Lebbell: Yes.

Senator Burchill: The Chairman has suggested a way that was propounded to yesterday as a sliding basis. Are you in favour of that?

Mr. Lebbell: It is administratively difficult. It adds complexity to it. I wonder whether it is necessary, but we would not be opposed to the concept.

The Chairman: There would not be any more administratively difficulties in that than if you are preparing tax returns for X, Y and Z. They have different amounts of income and different rates.

Mr. Harrington: We have no very great strong feeling.

Senator Molson: Mr. Chairman, there would be considerably less complications than integration, probably.

Mr. Lebbell: Yes, sir.

Mr. Harrington: Yes.

The Chairman: Are there any other features that we have not dealt with yet that you would like to bring up?

Mr. Harrington: Well, there is one part, and we brought a gentleman here to discuss it. Pension plans, retirement savings plans which are a very important part of life in this country or in any civilized country—Mr. Bray prepared the work on that, starting at page 15 and following. Perhaps he could speak to it.

The Chairman: Yes, Mr. Bray.

Mr. Bray: Mr. Chairman, section 2.52 of the White Paper states that rules are required to ensure that trustees deduct taxes from payments out of pension plans. We are rather alarmed as to why that should appear in the White Paper because the only payments out of pension plans are benefit payments, which are subject to withholding taxes, death penalties for examination benefits, and the trust companies are very strict in withholding these taxes. This is required by section 47 of the Income Tax Act, and there are substantial penalties if you do not do it.

We have always, as an industry, been very, very careful to see that the taxes are deducted. We cannot see why this should occur at all.

I think perhaps there are only two real proposals in the White Paper which cause some concern on the part of trust companies. One of them is the question of limiting investment in foreign securities to 10 per cent of the funds. At the present time there is a limit of 10 per cent on income. Ten per cent of income at the present time means that you can invest in growth stocks in the United States where the dividends are relatively small and, as a result, perhaps 30 per cent of the book value of your equity portfolio could be in foreign stocks.

To all intents and purposes, in most pension funds foreign stocks are U.S. stocks. Relatively few pension funds invest in anything other than U.S.

Now, this limitation of 10 per cent of the fund is, we think, too confining. Our recommendation is that, if a limitation must be imposed, it should not be less than 20 per cent.

Senator Beaubien: This is capital, Mr. Bray? You are not talking about income. You are talking about capital.

Mr. Bray: Capital, right. As I say, the present arrangement of 10 per cent of income of a fund—this includes all income, bond income, mortgage income and not just income from stocks—10 per cent of income is the limitation and, as I say, you can have in a lot of portfolios as much as 30 or 35 per cent in U.S. stocks. But that 10 per cent of book value on your portfolios has been reduced to, we think, ridiculous limits.

I am not an investment man and I think that part of one's investment strategy is that there are certain industries, if you want to have a well diversified portfolio, which are not available in Canada. For instance, Business Machines. Most portfolios today, I understand, have I.B.M. and Xerox. We do not have them. Drug manufacturing is not available in Canada, so that to limit your book value to 10 per cent actually reduces the scope of the investment of the fund and hence its future growth.

The Chairman: You are speaking in relation to both pension plans and retirement savings plans?

Mr. Bray: Right.

The Chairman: There is an aspect of that—are you the one to deal with it?—and that is the averaging under the White Paper as against the present statute.

Mr. Bray: Yes. At the present time we believe that the existing system is pretty fair from the standpoint of the revenue and of the taxpayer. We have no quarrel with any change in the formula for averaging, but our brief just states that as long as the formula does not increase the tax now paid under the existing averaging formula.

The Chairman: But the formula does increase the tax. We have had a lot of evidence here, including Defasco and other companies, that have retirement savings plans, and I would say that in many instances the tax is doubled.

Mr. Bray: I think it probably would be.

The Chairman: Here you have a man contributing over a lifetime and getting an exemption for his contribution when the income tax rates were much lower, and now when he comes to the point where he wants to realize on that, if he takes it out in a lump sum—and the evidence was that a lot of them preferred to do it that way—then their tax is

at least doubled, as against what it would be under the present law.

Mr. Allison: Mr. Chairman, I think generally our position on the averaging proposals is that they are entirely inadequate. They do not do the job that they are intended to do, and that is to even out and to set up safeguards against widely fluctuating incomes. Certainly, if the present election under section 36 is removed and lump sum payments out of pension funds must be dealt with under the averaging provisions, then there is no doubt that there will be substantial increases in taxation.

The Chairman: But is that not a negation of what is flaunted in the White Paper as being the object—equity and helping out the man at the lower level? The man at the lower level of income spends a lifetime providing for his retirement, and then when he comes up to retirement he finds his tax doubled. Obviously, he would not think much of the White Paper.

Mr. Allison: I would certainly agree.

The Chairman: Have you thought of it in terms of adjustments that might be made?

Mr. Hobbes: No, we have not thought of any alternative formula. What we really feel is that there is an administrative problem, and that is that you can only go back so far in your record keeping to average incomes, unless the National Revenue computers are going to do it.

The Chairman: Section 36 is three years.

Mr. Hobbes: Yes. Say you take a five-year average, a lot of employees, blue collar workers and so forth, do not keep very good records. As a result they might have the last two or three years' tax returns, but they do not keep them back to time immemorial, so we feel that the existing system of three years is more practical and more equitable, but we did not come up with any formula different from section 36 because we believe that section 36 is good.

The Chairman: Does the averaging provision in the White Paper extend the scope of averaging? Would that be a basis for some change in section 36, to broaden it, or is that necessary?

Mr. Allison: I think, Mr. Chairman, the averaging provisions do extend the scope; there is no doubt about that. There are items of income that cannot be averaged now and that under the proposal you will be able to average. Again, I may say, our stand is that there should be some form of averaging across the board to take care of other types of fluctuating income that presently are not covered by section 36. The proposals that are made for averaging are entirely inadequate.

The Chairman: Would you like to elaborate on that? You say they are entirely inadequate. Do you mean in the lack of broadness in the coverage?

Mr. Allison: That is right.

The Chairman: That could be accomplished by amending section 36.

Mr. Allison: By extending the scope of section 36.

The Chairman: Yes.

Mr. Allison: Exactly.

The Chairman: Are there any other questions on this? Have we any other headings that you would like to develop, Mr. Harrington?

Mr. Harrington: No.

Senator Isnor: Mr. Chairman, just before we leave pensions, have you any idea of the percentage of pensions paid in lump sums as compared to pensions extending over the period of retirement?

Mr. Bray: You say "pensions paid in a lump sum." As a matter of fact, normally pensions cannot be paid in a lump sum. They must be paid in equal periodic, either annually, quarterly or monthly instalments, over the lifetime of the pensioner. The only exception is when pension accumulation is so small that he would be getting a cheque for $3.10. Actually, it is under $10, which is the allowable amount, in which case a lump sum may be paid to him. If the capital in the approved pension plan is such as to pay $10 or more per month then it must be in the form of a periodic monthly check.

The Chairman: We are talking about lump sum payments in relation to a retirement savings plan, senator.

Mr. Bray: Even with that, Mr. Chairman, the retirement savings plans require—it is one of their basic ground rules—that the proceeds of a lifetime of saving must be used to purchase a life annuity, and the only time

that a lump sum can be paid in the case of a retirement savings plan is in the case where the capital sum on retirement is not sufficient to purchase more than $5 per month.

The Chairman: Then the lump sum payment would arise particularly in what are called profit-sharing plans, and in the profit-sharing plans, as we understood from the evidence, there is a right to take a lump sum payment or an annuity.

Mr. Bray: Yes, that is right.

Senator Macnaughton: Mr. Chairman, dealing with non-resident investors there is a very interesting and definite statement in your brief that the proposed treatment is discriminatory and probably self-destructive. We have not had too much evidence on non-resident investors, and having regard to the importance of the witnesses and the association they represent I wonder if someone can elaborate on this.

Mr. Harrington: We can do that readily. The whole section starts at page 70, and I will ask Mr. Hobbes to deal with NRO's.

Mr. Hobbes: I think, sir, the position here is very simple. I think there has been a question already on this matter. The NRO makes it possible for a foreign investor to make use of a corporate form which is convenient for administrative purposes, and yet not suffer any more tax than he would suffer if he held the assets directly. If he holds them directly he suffers a 15 per cent withholding tax. The same principle applies in an NRO company.

As we understand it, and as you know, there are a lot of details left out of the proposals. We have to fill these in by guesswork. As we understand it, and NRO company would be more or less like an ordinary corporation, and we find that this again is an anomaly and a retrograde step in the sense that it confuses the form and substance of the situation.

The Chairman: Two things ar likely to happen. One is that the NRO corporation is likely to disappear, and it may well be that the man and his money will disappear too.

Mr. Harrington: We have a concrete example of that, and I am sure my colleagues have one as well. I am thinking of one group which has investments of $150 million in Canada in NRO companies. These are portfolio investors. These are not people who came here to grab Canadian companies, or anything like that. They have been putting money into Canada for over 50 years and, therefore, they have contributed greatly to the buildup of the country. They have told me that if the White Paper goes through then, as you say, the money and the people will disappear. This is not very desirable.

The Chairman: No, not when it is a source of revenue and development and purchasing power that does not strain the resources of the Government of the country.

Senator Macnaughton: You say that non-resident investors bring a great deal of economic benefit to Canada.

Mr. Harrington: Yes.

Senator Macnaughton: That is what we want on the record.

Mr. Harrington: We know that they do.

Mr. Bray: May I make a comment?

The Chairman: Yes.

Mr. Bray: This relates back to my earlier remarks about investment funds, because this is a very serious problem there. Most of the trust company funds have non-resident participants—not a great many, but some—and under the proposals the tax that would be collected from the trust, while it is recoverable in some degree by Canadian residents, is not recoverable by a foreigner. There is no way in which he can recover it as an offset. Therefore, he is subject to a capital gains tax to which he should not be subjected. This is perhaps another aspect of the same question.

The Chairman: Are there any other points?

Mr. Harrington: I think you have drained us, Mr. Chairman.

Senator Molson: Mr. Chairman, I should like to ask another question before these witnesses depart. I am wondering if they would care to express any opinion as to whether the proposals in the white paper would in any way complicate the task of the administration of the Income Tax Act, the filing of returns by corporations, or the task of the ordinary humble individual in making up and filing his return.

Mr. Harrington: Well, I would say "yes" to all. In fact, the computer people, whom we asked to think about this a little bit, said that even with the enormous resources that computers have this could lead us into an

administrative jungle of such proportions that we would just bog down in there, and become a nation of record keepers, bookkeepers, and paper movers, and much more so than we are at present.

The Chairman: And you would not be able to earn money.

Mr. Harrington: It would be impossible.

Senator Molson: Are you suggesting, then, that if the White Paper Proposals were implemented tomorrow the whole system might be in danger of breaking down, and that we might be unable to cope?

Mr. Harrington: It would certainly slow down terribly, and in some aspects of it there does not seem to by any answer to some of the things they would ask you to do.

The Chairman: Thank you very much, Mr. Harrington.

The Chairman: The next brief is that of the Toronto Real Estate Board. Mr. Stikeman will make the opening statement.

Mr. H. H. Stikeman, Counsel, Toronto Real Estate Board: Mr. Chairman and honourable gentlemen, I would like to introduce the people whose names appear in the second group on the printed sheet that is before you.

On my extreme right is the gentleman whose name appears first on the printed sheet, Mr. Kirkup, who is the chief of Public Relations and the Research Director of the Toronto Real Estate Board.

Next to me is Mr. Strung, who is the present president. He is an evaluator so he brings a little more objectivity, perhaps, than some of us connected with this organization since he really does not mind whether the things we object to happen or not because his business will remain constant, or will get better.

Then there is Mr. Magee, who is the past president and the current chairman. He is also the president and chairman of A. E. LePage. He has a direct interest in the real estate business, and I need say no more.

Mr. Dart, who is at the end of the table, has recently become a partner in Price Waterhouse. I would say a contributing factor has been his excellent performance on many briefs before this committee and the committee of the House of Commons, and we are very pleased to have him with us again.

I should state that we view the function of our presence this morning primarily to be brief. In the course of being brief we shall try to expose to you the highlights of our submission, and then make ourselves available to answer your questions.

We represent about 25 per cent of the number of bodies that are represented by Mr. Vineberg in the CARAB (Canadian Association of Real Estate Board) brief, which was before you on April 30. We are confined to the Toronto area. We have about 6,500 members. Because Mr. Vineberg did such an excellent job for CARAB, he saves us the task of dealing with some of the subject matter in our brief. Also, because some of the remarks of the Trust Companies Association immediately before us, we can further cut down the time of this committee this morning.

The underlying theme of our brief, which we put in the introductory pages, is that the impact of the White Paper upon the real estate fraternity will drastically increase the cost of rental housing. We have tried to get away from special pleading and aim at a more fundamental issue, which is that the White Paper and its impact upon the real estate business as a whole will raise the price of rental housing and inhibit the building of new housing beyond all expectations. We have got quite a lot of research ability around this table, and we will speak to the points in our brief that have particular reference to that.

Also before leaving the room, I would like to put before you a couple of pages of the statement Mr. Robert Bourrassa, the new Prime Minister of Quebec, made in Winnipeg on June 5. I was given this yesterday by the Minister of Revenue of Quebec, and informed that if we subscribed to its terms we might make it part of our submission today. We studied it last night, and we feel that the recommendations on the summary pages as to the treatment of integration, capital gains tax, the small corporation and the widely held and closely held companies, fits in so well with our thinking that we wish to adopt it formally as part of our submission today.

We also feel that it is material in view of the questions asked by this committee of the previous group here this morning, concerning what they thought about integration and the problems of imposing a 25 per cent rate of capital gains tax. When we come to this point, you will note that the Quebec submission is

even simpler, and in our view deals with the core proposals of the White Paper in such obviously easy terms that it is amazing to me they have not been put forward before. Rather than imposing a 25 per cent rate of tax upon capital gains, Quebec proposes that only 50 per cent of the capital gain shall be included in income, and if there is a maximum tax of 50 per cent there is in effect what our chairman suggested was a sliding rate, the lesser of the 25 per cent for the individual's effective rate. Quebec proposes to do that without implying or acquiring a sliding rate.

I am getting ahead of my story. If we bear in mind the central theme of this submission, which I started out by indicating, we can go straight to the first question, which is the capital cost allowance. It is implicit in the White Paper that the capital cost allowance schedule and its application will be revised, but we are not told how. We start from the very beginning of the brief and go right through the first five or six pages on this subject. I am assuming honourable senators have or will read this in detail, and I do not wish to take up your time by merely reading what we have written.

On page 3 the basic submission is made when we quote the Carter Report, where it was stated regarding capital cost allowance that:

> Liberal allowances are probably inherent in any simple system, and the present rates therefore appear generally to be satisfactory. As we suggested in chapter 4, a degree of liberality here can be accepted because it would probably assist in economic growth. We therefore recommend that the basic system of capital cost allowances for depreciable assets and the general level of rates remain unchanged.

The present capital cost allowance system was devised by Mr. V. W. Scully, who is presently chairman of the Steel Company of Canada, who was a very hard boiled accountant and tax administrator; he did not give anything away. He devised a system which has worked extremely well, which has lasted for 18 years, which is understood, and upon the basis of which every major business decision is to some extent founded. To become less liberal against the background of what Mr. Scully has provided us with is, in the words of the Quebec statement, and of our own thinking, a retrograde act, in that it is putting equity and complications in the place of the desire to advance the economy, which the White Paper states is one of its secondary aims in the first few paragraphs.

The White Paper, as you know, attacks the capital cost allowance system by purporting to close three existing loopholes. We will not discuss whether or not they are loopholes; we deal with that on pages 4 and 5. The principal loophole at which the White Paper aims is the one described as the availability to private investors in the professional classes—notably doctors, dentists and some lawyers—of pyramiding holdings in rental real estate property so as to reduce their other income by the capital cost allowance they may thereby claim, and then expecting to die with those assets still unrealized and passing them on to their heirs without recaptured depreciation on the footing of fair market value. As Mr. Vineberg so ably said, people do not die to escape tax. The minister's answer, however, is that people do set up their real estate holdings in anticipation of the inevitable death so as to save tax. That is a rather far-fetched loophole.

When we consider, as Mr. Strung will tell us in a moment, statistically how much real estate in the rental housing area has been financed and is owned by individual investors, we come to the question whether or not this is in fact a loophole meriting that term, by virtue of being limited to the professional classes in small numbers, or whether it is not a progressive symptom of the investing fraternity who are sophisticated enough to see in real estate the opportunities for long term gain, and, by their sophistication and their reliance upon the present capital cost system, thereby enabling low cost housing and relatively moderately priced rental housing to be continue to be constructed, particularly in the Toronto area.

I will come to the other aspect of this attack when we have heard Mr. Strung on this point.

The other aspect of the attack on the present capital cost allowance system in the White Paper is, of course, to single out the real estate investor for rental income from all other types of investors by requiring him to compartment his investment into $50,000 packages, and to suffer recaptured depreciation, or to be deprived of the carryover of losses derived from the realization of those packages.

The Chairman: How can you regulate your purchases of property for rental on the basis of a capital cost of not more than $50,000?

Mr. Stikeman: You cannot. In any event, why should they say that the fellow who buys real estate for rental should be treated differently from the one who buys it for business purposes.

Now, when we deal with the first point, that is the question of the importance of the individual investor for rent in the creation of moderately priced rental properties and the continuing development of such properties, I would like Mr. Strung to speak. I think it is fitting that he starts with the examples to which we refer at the bottom of page 6. These examples are on the last two pages of the brief, known as Exhibit A. Mr. Strung prepared these, and I am not going to ask him to go through them in detail and give you the results of his findings in the course of the preparation of it.

Mr. J. Strung, President, The Toronto Real Estate Board: Thank you. Mr. Chairman, we have found in the Metropolitan Toronto area, and I am quite sure this is common throughout other areas of the country, that many apartment buildings and apartment investment properties have been selling at unusually low rates of return. I suspect that part of the reason for the low rate of return, and why anyone would invest his money on the basis of this low rate of return, is because of the inflationary trend, anticipating increased rents over a period of years, which would then show a more appropriate rate of return on their investment. The second and perhaps most cogent reason for people investing money at these low rates is the capital cost allowance benefits to these professional people who have been referred to before.

Our statistics indicate that approximately 57 per cent of the rental accommodations are held by private individuals as opposed to developers and large corporations. This suggests that a fairly large percentage of the dwellings that are being rented are owned by these people to whom the White Paper is specifically directed.

By way of illustration I may direct your attention to the last Exhibit A, and an apartment building located at 1002 Lawrence Avenue East. As it was suggested, I do not propose to go through all of this. At the moment it indicates that this apartment building sold at an overall rate of return of 7.7 per cent before any allowance for recapture of capital had been made or any depreciation allowances were made. The apartment building actually sold for $730,000. The net income before depreciation was $56,183, representing 7.7 per cent.

Our submission is that if the capital cost allowance benefits are taken away from these investors, then they will quite naturally insist upon an appropriate rate of return, because the benefits which attracted them to buy at this low rate of return will be gone.

The Chairman: The rents would go up.

Mr. Strung: That is right. If the investor said that he would invest on at least 10 per cent net income as opposed to 7.7 per cent that would require a rental increase of 16.4 per cent. The fact that mortgage interest rates are $10\frac{1}{2}$ per cent further decreases the net return that the investor now receives and it would further require an increase in rental in order to provide him with the necessary competitive rate of return.

This nominal rate of return has adversely affected, among other things, the rate of dwelling starts. The dwelling starts across the country are down by 43 per cent, notwithstanding that the Economic Council of Canada in its Sixth Annual Review, entitled Perspective 1975, issued in September 1969, had this to say dealing with housing:

> In view of the large rise in the total housing stock required to 1975 under conditions of rapidly rising levels of new household formation, it is essential that a high rate of new residential construction be maintained, and that there should be no major setback in this sector, such as occurred in 1966. Indeed over the next year or two, it is particularly important that a very high rate of new housing completions be achieved to increase the relatively low vacancy rates now prevailing in various major Canadian cities. This is one essential requirement for achieving a moderation in the recent very high rates of advance in shelter costs. In these circumstances it is vitally important, especially under the financial conditions of today, that the seasonally adjusted annual rate of new housing starts be carefully monitored month by month. If there should be any clear sign that new housing starts are falling off in a significant way, possible remedial actions should be quickly considered. We are now in a situation in which a major

housing crisis could develop within a very short period of time.

We are probably right in this major housing crisis now, because the housing starts are down 42 per cent. It is our submission that if the White Paper is implemented and the capital cost allowance benefits are taken away from these investors, the dropping of dwelling starts will increase even more, thereby worsening the housing shortage we now have.

Mr. Stikeman: Mr. Strung has told me that three years ago the NHA interest rate was 6½ per cent. It is now, as he said, 10½ per cent. He tells me that for every one percentage point the rental goes up $40 per month, assuming that you have a mortgage of $12,000 per suite. This is $10 a month interest. The average suite costs you between $12,000 and $19,000 to construct. Assuming you have a $12,000 mortgage you are going to pay $10 a month for $12,000 for every one per cent of increase in the NHA rate. If the individual investor is deprived of the collateral facilities of the capital cost allowance, which is given him under the present law, he will not put the money out without raising the rent drastically. I think that is your point.

Mr. Strung: Yes.

The Chairman: It is a case of whether you give an incentive or take it away.

Mr. Stikeman: It is not only an incentive, but you have got to think of the inversion phenomena.

The Chairman: The capital cost allowance is a form of incentive.

Mr. Stikeman: That is right.

The Chairman: When the company gets that then the proposals in the White Paper will effectively take away the benefit of it.

Mr. Stikeman: The Carter Commission said at the very beginning that it should be a liberal kind of thing. Mr. Scully, for all his hardheadedness, was liberal.

Mr. Magee is going to point out another situation which is called the inversion phenomena.

Mr. B. R. B. Magee, Chairman, The Toronto Real Estate Board: Mr. Chairman and honourable senators, there is a brief article which appeared some months back, enlarging on what Mr. Strung has said. Normally, one would expect when making an investment that the person putting up the mortgage money would have a better security than the equity holder. Normally, the equity holder would expect a higher rate of return than the mortgage holder, because the risk is less, everything else being equal.

About three years ago, because of the number of situations, this inversion phenomena had become apparent across our country. Basically, in a few simple words, it means that we find owners of equity of real estate receiving yields considerably less than the first mortgage rates, and as low as 6 per cent in certain areas; 7 per cent in apartment houses, and 10 per cent in shopping centres and so on across the board, whether industrial properties or other properties.

One of the main reasons investors are not prepared to accept this capital cost allowance is, as Mr. Strung said, that if his capital cost allowance is modified or removed, then the owner of the equity will require a larger return for his investment, and consequently rental costs across the board will increase. You might as well say, if that is the situation, why are people continuing to build? I think there are a number of reasons, over and above that. It is a question of present day construction costs, high as they are, and the attitude of labour, that you will probably never find land and construction costs coming down, unless we have a very very major depression, which I hope we will not have.

You have read in the papers and you have seen some of the wage increases that have recently gone through, far above any Government guidelines—50, 55 per cent in the construction industry in the Toronto area, and it is hard to know what the cost of shelter accommodation will be in the future.

The other thing is that the investor feels that eventually he may get onside. Rental rates at the moment in the metro Toronto area are considerably low in the market. There is a very drastic curtailment in the number of new apartments being built, simply because it is not economical for anyone to go ahead and develop a negative cash flow.

Certain people have organizations that they wish to maintain and they more or less are building what buildings they are proceeding with now, on the basis of keeping their staff together. It is one of the most difficult things to build a good organization, it is very easy to lose it, and a lot of them are prepared to subsidize that building operation by continuing to build.

Those are the main reasons. If it might be of interest to you, Mr. Chairman, and to your colleagues, I could make available this inversion phenomena, but in the interest of time, someone might see fit to read over it and perhaps study it. It is about four pages long, but it covers the thing quite adequately.

Mr. Stikeman: Is it your point, Mr. Magee, that that would be accentuated by the White Paper proposals?

Mr. Magee: There is no doubt about that. If the Government sees fit to change capital cost allowances, it is just another nail in the coffin for the development of rental accommodation in this country.

Mr. Stikeman: Do you think people would still continue to accept the negative cash flow to maintain their investments?

Mr. Magee: Not really, no. I think you have already seen many major builders who are just sitting on the sidelines now. The demand is still there for accommodation and, with the shortage of supply, you are going to find rents continuing to escalate quite dramatically. I do not think we have seen the really dramatic escalation of rents yet.

Mr. Stikeman: You are speaking entirely of rental income investments?

Mr. Magee: The same thing applies to income new homes. At the present time, the cost of a new home in Toronto is running around $42,000.

Senator Beaubien: Mr. Magee, would it be helpful, do you think, if the Government made a statement saying that, if there were any change in the capital cost allowance, it would not apply to present buildings or buildings that were started?

Mr. Magee: Senator Beaubien, I think it would be helpful, but it is not really going to solve the problem, because this country is still short of accommodation and for the future we are going to need a lot more buildings, if the population is going to continue to grow.

The Chairman: Are there many operations in Toronto where a pool would exist which the White Paper proposes to take away? I understand the White Paper proposes that a property costing $50,000 or more is a separate entity and your write-offs are in relation to that and your recaptures are in relation to that. Are there many organizations where they would have a class?

Mr. Magee: Yes, Mr. Chairman. I think that will probably be covered a little later on today by the Institute of Public Real Estate Companies, who are involved in that, so I will not mention that. It is certainly discriminatory as far as the real estate investor is concerned. I think Mr. Stikeman has said it earlier. This proposed $50,000 a year class applies to an investor in real estate, yet it does not apply to Loblaws or to Imperial Oil in a service station or to any other company which is using real property to create other income, where, as we read the White Paper, they are allowed to incorporate that in a pool of their general assets and take their depreciation across the board.

The Chairman: Supposing I bought one property that cost $100,000. Then, except the possible reduction in capital cost allowances, how otherwise would one be affected by the White Paper proposals?

Mr. Magee: The question of your loss carried forward, and the number of investment properties, they do not generate their full cash flow initially. You would have tax losses. As far as individual homes are concerned, if you happened to have any losses, the White Paper proposes that no losses would be deductible, yet the propose to tax you on a capital gain.

The Chairman: The no loss deduction there is in relation to the fact that it is the capital cost allowance that creates the loss.

Mr. Magee: I was referring to homes, sir.

The Chairman: In the homes, of course, if they are home owned, the problem does not arise. It is homes, rental homes, that they are talking about and that the White Paper deals with, is that not right?

Mr. Stikeman: Yes, you are quite right, Mr. Chairman. The loss of which you are speaking is the loss in excess of the $50,000 capital cost allowance. You lose that, but you get it up to the $50,000. We deal with that on pages 9, 10 and 11 of our brief, which pretty well says what Magee has said.

I think the point is that this particular portion of Article 5.17 in the White Paper—which makes the distinction between real estate held for another income over real estate held for any other purpose—In limiting

the capital cost, cost by cost, to $50,000, and preventing the pooling of the assets, as Loblaws might do, vis-à-vis the rental investor—is in danger, in the eyes of this committee, of driving investment money away from the creation of rental real estate, into other forms of real estate investment. It has the same effect, of course, upon the shares of real estate companies whose assets are rental real estate investments.

Senator Phillips (Rigaud): To what extent would it increase the rate of rental?

Mr. Stikeman: That I cannot say.

Senator Phillips (Rigaud): I know there has been a surprising indication to me that the private sector contributes—what percentage...

Mr. Strung: 57 per cent.

Senator Phillips (Rigaud): 57 per cent of the total amount. There are two problems with capital cost allowances. One is the general observation in the White Paper, that they intend to deal with this in due course. That is one of the "manana" problems, it is a Delphic utterance and we do not know what it is going to lead to. I suppose they have to wait and see until they come out with the suggestion. Of course, there is serious reactions by way of complaint generally, but uncertainty is created by the very observations. There is nothing that this committee can do about that, other than this place being a forum for the expression of opinion, that you do not say that you are going to do something and you are going to deal with it, and creating the uncertainty, when no one has the faintest idea of what they are going to do, even to the extent of possibly saying we can eliminate capital cost allowances completely.

There is no question about the unsettling aspect of that observation in the White Paper; but I do not think we can do much more, having said that.

Coming specifically to the next range effectively in this submission, the general discriminatory effects are clear, there is no question about that. It is the only type of investor that is being singled out for discriminatory adverse treatment, in the treatment of capital cost allowance. Having said that, I do not think public opinion will be aroused at discrimination to investors, unless we can relate it to damaging consequences to tenant rentals.

The Chairman: I would like to know what this would be.

Mr. Strung: If you will look at Exhibit A, this particular illustration indicates that the rents would have to go up as much as 16.4 per cent to provide the investor...

The Chairman: Exhibit A on the last page.

Mr. Strung: First of all, we are dealing with the value of the property rather than an increase in rental income.

The Chairman: Let us deal with that because I think that is the crux of your case.

Mr. Strung: On this particular building, for simplicity's sake, the mortgage has been left out. The property sold at $73,000 and the net income, after all expenses but before any depreciation allowances were deducted, was $56,183. That indicates that the investor received 7.7 per cent before he made any allowances for recapture.

Actually it was less because, if he were allowed, let us say, even 2½ per cent depreciation on, say, 60 or 65 per cent of the $73,000, as represented by the building, then his net income would probably be 5 per cent or around 5.6 per cent, or something like that.

He was prepared to accept this lower rate of income because of the capital cost benefits as part of the reason.

If we take this benefit away, then an investor would insist on getting a competitive rate of interest. That one incentive is gone, so he would say to himself, "If I can get 10½ per cent on first mortgages where I do not have any management burden at all and have the greatest degree of liquidity, much more so than if I have my money invested in equity and at the same time I have not got the risk involvement, not nearly as much risk as in equities. So, I would want at least one or two points greater return for my equity investment than I can get from a mortgage company."

If we were to add all these things in I would suggest that rents would probably increase something like 30 or 40 per cent.

Senator Phillips (Rigaud): Where have you got that?

Mr. Strung: This is not in here. In this particular illustration we suggest a 16.4 per cent increase would be required to provide this man an overall return of 10 per cent.

The Chairman: Is it at the bottom of the last page.

Senator Phillips (Rigaud): At the bottom of the last page.

Senator Carter: May I ask you whether that 16 per cent now is just the exact equivalent of the capital cost allowance that is being lost?

Mr. Strung: I beg your pardon?

Senator Carter: That 16 per cent increase in rents—will that exactly cover the capital cost allowance which is being lost?

Mr. Strung: No, senator. That is merely an illustration to show how rents would have to increase to compensate for any greater net return that an investor would insist upon if he lost some of the attractions for investment, i.e. the capital cost allowance benefits.

In all likelihood, even the 10 per cent is merely used here because it is a round figure. No investor would buy an apartment building if he did not have these other investments at 10 per cent net return if he could invest his money in first mortgages at 10¼ or 10½ per cent, where he has no management burden, and where he can convert the investment into cash much more quickly than he could with equity.

So, he would have to get more than 10 per cent, and substantially more if first mortage rates are higher. This illustrates how it would affect the rental income. In all likelihood, the rental of apartments would probably increase in excess of $30 or $40 a month.

Even at 16 per cent, an apartment building having a rental of $200 a month would be subjected to a $30 a month increase.

Senator Beaubien: Perhaps Mr. Stikeman could explain the capital cost allowance being deducted from the income; how it saves money for the investor.

Mr. Stikeman: Well, the White Paper gives an indication of that in paragraph 5.17. But the individual investor, who has large amount of investment or professional income, says, "I will invest $100,000 in the acquisition of a rental property and I can depreciate the property at 5 per cent on a diminishing balance. If I put $1 million in I get $50,000 against my total income. Therefore, I am not too concerned whether the rent that I get from that property is very high or very low. What I am looking at is the collateral benefit of reducing my other income.

Once this benefit is taken away my attention comes back to the yield I can get from that particular property. It has got to carry itself." That is what Mr. Strung says makes the rental income suddenly become so expensive.

Senator Phillips (Rigaud): But the real problem is that in many cases criticism arises from the graduate income tax.

Mr. Stikeman: That is right.

Senator Phillips (Rigaud): Because depreciation works out to the greater advantage of those in the higher brackets.

Mr. Stikeman: That is right. It is progressively tougher.

Senator Phillips (Rigaud): And this is because the incentive on the higher bracket has been taken. Those who suggest change find there is virtue in that.

Mr. Stikeman: That is right.

Senator Phillips (Rigaud): One wonders whether there might be some compromise approach to this, that the degree of depreciation should relate itself to the taxable income of the investor.

Now, I know that once you start to play around with that you get back into a form of discrimination, and this is a very good example that when you try to get an ad hoc solution to a specific problem on the one hand, Mr. Chairman, you create the horrible social result of increased rentals for the average person in a modest apartment house. But, as against that, one must be realistic.

It has been said by some people in the higher income brackets, that with the graduated scale of taxation, the problem would not arise if the Utopia of the 50 per cent rate suggested in the White Paper were realized. You know what I think of that approach. It is the graduated rate of taxation that gets above the criticism.

I think, Mr. Chairman, we are facing the same problem here with respect to the incentives to industries, where you try to reach a bonanza situation with ad hoc legislation, and if you attempt to do so then you strike at the whole incentive process in the development of natural resources in our country.

The Chairman: That is what has happened here.

Senator Phillips (Rigaud): Yes, it is exactly the same thing. We have got to say—really, I am speaking as one member—that, admittedly, under the graduate rate of tax, there are benefits to those in the higher income brackets. However, I think that in this case we should set the Minister of Finance right, that if we accept the 50 per cent rate, binding upon future finance ministers by constitutional amendment, the discrepancy, therefore, will not be serious.

The Chairman: I would like to have Mr. Stikeman suggest—if you were given the opportunity of rewriting this provision in the White Paper, realizing that you cannot go back to the existing law, what would you propose?

Mr. Stikeman: I think I would eliminate it and the existing law. I think that if 57 per cent of the rental income is reduced by investment from investors, they should be treated on the same footing as the commercial real estate purchasers who use it for the purpose of producing income. It should be treated as his business, like a manufacturing concern, or the CCA should be denied to all of them on the same footing.

The thing which is bad, I think, is the discrimination. If you leave one part of the investment in real estate open to the same advantages we have today and close the private individual investing sector through the provisions of rule 5.17 of the White Paper, then you are not only discriminating, but you are driving money out of that particular field.

The Chairman: Yes, but in your comparison there is a built-in protection so far as business is concerned. The man with a professional income who wants to reduce the over-all burden of taxes by making this investment would not go out and buy a business.

Mr. Stikeman: No.

The Chairman: Because there are more problems in handling a business than there are in handling an apartment building.

Mr. Stikeman: But you have got the cure at the end of the line, when he dies, in the White Paper. Now you are not going to allow him to pass it on to his heirs at the fair market value, and without recapture.

Senator Phillips (Rigaud): May I suggest something to you, Mr. Stikeman, because you are probing for suggestions. I think we have to relate this problem to capital gains. Let us assume that only 50 per cent of the capital cost allowance is presently allowed as a deduction from normal taxable income, then there would have to be a corresponding adjustment from the point of view of capital gains tax realized on the sale of the property and in that way you might get a sort of a balanced justice here. The introduction of a capital gains tax in my mind introduces an opportunity for flexibility. Now I am coming back again, and I am sorry for taking so much time, but I am familiar with this problem in professional practice, but once you start playing around with discrimination, it is dynamite, as the saying goes, because the discrimination is there. On the other hand, there is the odd benefit given to the singled-out person which public opinion does not like, and my understanding of your answer is that 50 per cent of the depreciation presently allowed should be the ceiling of the deduction from taxable income with corresponding adjustments in due course in capital gains.

Mr. Stikeman: It is a good suggestion. Mr. Dart has done quite a lot of research on this. How does Senator Phillips' idea strike you, Mr. Dart?

Mr. R. J. Dart, Accountant, The Toronto Real Estate Board: To be quite honest with you, I couldn't quite hear Senator Phillips' question.

Mr. Stikeman: I think his point was that if you reduce the capital cost claimable to 50 per cent and make an adjustment in the capital gains, net, which catches that on disposal, you will permit the man to enjoy the benefit of his investment while he holds it and take his chances and make his own choice as to when he disposes of it. It is not a bad idea.

Mr. Dart: I think it is a little too complicated.

Mr. Magee: They are still getting their bite at the cherry and also recapture if he disposes of that property. I mean it is only a deferment, this capital cost allowance, it is not a benefit in perpetuity.

Senator Phillips (Rigaud): But the answer to that, Mr. Magee, is that a deferment is like a man in the natural resources industry where they always think that they will eventually achieve a taxable income but meantime they strive for lower tax holidays, and what we are trying to do is to get some balance in these things.

The Chairman: But, Senator Phillips, the thing that they are trying to get at is the use of other earned income and to reduce the impact of taxes on that by making use of the capital cost allowances in connection with an apartment house they might acquire. If you can put a limit, as you suggest, on the amount of write-off they can apply against their other earned income, then you have met the problem. Maybe you have not beaten it, but you have reduced the impact.

Senator Phillips (Rigaud): Yes, you have compromised with the problem and met it up to a point.

The Chairman: That is right.

Mr. Stikeman: You are decreasing the allowance and you are decreasing the tax at the end.

Senator Phillips (Rigaud): You are levelling it off and the capital gains tax would bring that up.

Mr. Stikeman: Or the recapture, whichever happens to strike.

Mr. Dart: Could I make a couple of comments on this proposal which I hope may answer Senator Phillips' question. The proposal in the White Paper...

Senator Phillips (Rigaud): Incidentally, Mr. Chairman, I may be out of the law business as a result of this suggestion. I may be without any clients.

Mr. Magee: "It is a far, far better thing..."

The Chairman: Do you want this part of the record to be marked confidential?

Senator Phillips (Rigaud): No.

Mr. Dart: The Government proposes to deny the deduction of a loss created by capital cost allowances because it is their opinion that the capital cost allowance rates are excessive. To the extent that they are excessive, they create an incentive to invest in real estate, which Canada badly needs. The public housing situation has been explained. I think both Mr. Strung and Mr. Magee have shown us that the benefits of the excessive capital cost allowance rates is passed on to the tenant because the return is low on most of the properties that they have looked at, and it only suggests to them that the landlord is willing to receive a lower return because of the capital cost allowance benefits he receives. We must recognize that if the Government does remove this incentive, it is not the landlords they are hurting, it is the tenant.

Secondly, how to do you distinguish or compute a loss due to capital cost allowance? Capital cost allowance is one item in determining a loss in a total income made up of all your operating expenses, mortgage interest, capital cost allowances and what have you. If an apartment building is half rented, your income is only going to bs half of what it should be, but your entire capital cost allowances will be with you, and you did have to incur the cost of the building. You have realized a true loss—it is an artificial loss—through the excess capital cost allowances. How can you in a proposal recognize a loss which is due to excessive capital cost allowances as opposed to a loss which is due to a building being half rented, or the rents being lower than you estimated when you projected your building in the first place—as to how much you could afford to pay for that building. Rents are too low, and capital cost allowances are higher than rental income and therefore you have a loss. It is not an artificial loss; it is a true l oss.

Senator Phillips (Rigaud): But we are dealing with two different points. You are relating the offset against your capital gains. The cost of the capital asset has nothing to do with operating deficits or loss of operating income. The question of an operating deficit may be related to the problem of depreciation, but not a combination of both.

Mr. Dart: I do not know how you distinguish a loss due to CCA versus operating deficits.

Senator Phillips (Rigaud): You don't distinguish it as an operating cost, but you distinguish it in the operation of a capital gains tax which is an entirely different matter. You cannot apply an operating deficit against a probable tax loss.

Mr. Dart: No, but I am speaking to the proposal to deny the deduction from other income of a loss created by capital cost allowances.

Mr. Stikeman: Senator Phillips, what he is saying is that you do not distinguish it at the point the loss arises, except you reduce the depreciation capable of being taken, but when you get to the end you have ear-marked that portion of the loss, as I understand it, which is created by the CCA and you deal with that differently. Is that right?

Senator Phillips (Rigaud): That is right.

Mr. Dart: But I would suggest that he deserves it today because his loss is realized today.

Senator Beaubien: Mr. Chairman . . .

The Chairman: Yes, Senator Beaubien?

Senator Phillips (Rigaud): I want to make it clear that I feel strongly on the point that it is a mistake to introduce a discriminatory aspect, more particularly when it produces damaging results in terms of rentals.

Senator Beaubien: Mr. Stikeman, in the case of an investment of $100,000 which you mentioned for a man who has other income, I do not see how the capital cost allowances could be a deduction from his other income. Now, take a building here where the revenue is 7.7 before the capital cost allowances are taken into account, and the revenue then at $100,000 would be $7,700. But the capital cost allowances on $100,000 would be $5,000, so there would still be a net income that he would have to add to his other income. There would be no reduction of his other income.

Mr. Stikeman: No, not as much, and then if he suffers a loss in the disposition of that building, he has it against his other income. It is a loss below the cost price and the C.C.A.

The Chairman: But as long as he ends up with something that is called profit in the operation of the apartment he has not reduced his other income. So where does the problem arise?

Mr. Stikeman: Principally on the loss.

The Chairman: That is that he operates the building at a loss?

Mr. Stikeman: The $100,000, is not a very happy example because it is too small. But on a very large investment—supposing you invest $1 million and your other income is $50,000, the C.C.A. would be of benefit to you there.

The Chairman: Yes, but that is an exaggerated case. And possibly their building goes into something much larger than it really is.

Mr. Strung: I think what the investor is viewing and the capital cost allowance he is making—I think he can deduct that as an item of expense, and he does not have to pay income tax on this amount of money.

Senator Beaubien: He stills keeps the money.

Mr. Strung: But he may have to pay at a later date if there is recaptured depreciation when he sells the building. He knows at the present time, while he has a taxable income of, let us say, $50,000 plus $20,000 for the building, he is also charged another $20,000 depreciation which he pocketed and he does not have to pay any tax on now. He may be caught when he goes to sell the building and has to pay it back, but at the present time, in addition to the $70,000—he has $50,000 income and $20,000 from the building and $20,000 depreciation, so that he has 90,000, but he pays tax only on 70,000.

Mr. Stikeman: The cash flow is improved by the depreciation, but you are right, that does not affect his other income.

Senator Beaubien: That is the only point I am making.

Mr. Stikeman: It is a good point. It enables him to take more home, and we have probably put it wrongly.

Senator Beaubien: I understand that, but it is not deducted from his other income.

Mr. Stikeman: You are quite right, and that is a good point.

The Chairman: Mr. Stikeman, what is the size of the problem? That is what we would like to know. Are they dealing with something that is very small or does it amount to any considerable sum?

Mr. Stikeman: I do not think it is very big and I think it is self-defeating because you have to keep on adding assets to the class and spending money to prevent the ultimate recapture. Not many people can do that. The real thing thereafter, I think, is the loophole of death, where if a man does not dispose of them and dies, his heirs get the fair market value without recapture, and they are stopping that.

The Chairman: If that is the problem, why do they not just deal with that problem? I thought this migh be a suggestion you might make, and even suggest the language that might be used.

Mr. Stikeman: You have got in ahead of us. I think you are right. That is the real answer to it. That is part of Senator Phillips' solution, except he is temporizing and is saying,

"We will not give them so much as they go along, but we will catch them in the end."

The Chairman: I repeat the offer I have made. That is that now we have narrowed and crystalized what the problem is and what the difficulty is they are trying to overcome, you put in words what you think overcomes that.

Mr. Stikeman: I think you are going to have to stop the transfer at fair market value on death, which is consistent with the application of capital gains tax or estate tax, or whatever you end up with, but leave it the way it is in the meantime.

The Chairman: I am assuming that everybody has inherent in his make-up a desire to save face. How do you save face in relation to the proposals here, and how much would deal with the situation and yet save face? That is a problem I am putting up to you.

Mr. Stikeman: That is a good question. I think statistically you could show that if 57 per cent of this part of the investment of real estate is in individual hands you have not got a loophole. If you have not got a loophole, then the urgency of doing something which appears to be morally beneficial is not as great. You might say that the loophole which appeared upon further examination seems to be a universal practice indulged in by far smaller investors than you think who do not get away with a very great deal, and you can take care of it very soundly by your third suggestion under 5.17, but not permitting them to pass it on at fair market value without recapture.

Senator Carter: I would like to ask a question arising out of the sentence at the bottom of page 10. You talk about a builder building, say, a hundred-apartment block and he rents 80 of these 100 apartments and has a high vacancy rate. Then you say that the "loss is regarded as a cost of establishing a new source of income."

I am inclined to agree with the White Paper on this, because the reason these apartments are vacant is because the rent has been set so high. If the rents were lower these apartments would not be vacant. Instead of setting the rate of recovery on about 80 per cent of its capacity and waiting a couple of years with vacant apartments to make the extra profit.

Mr. Stikeman: What you are talking about, senator, is not the rate of capital cost allowance, but the rate of yield that the investor seeks to obtain. The higher his yield is forced up by the loss of the collateral benefits of the present capital cost allowance system, the less he can accept initial vacancies.

Senator Carter: How can that be "regarded as a cost of establishing a new source of income"?

Mr. Stikeman: He is prepared to accept a few years of partial vacancies on a temporary basis as laying a foundation by which he hopes the future will see the building filled and therefore recover. But he cannot do that if he does not get his capital cost allowance carried forward to offset that income flow when it comes in.

Senator Carter: That is true, but we have been talking a lot about deemed realization here, and this is the first example I have come across that seems to partly justify it. I think with the housing shortage we have all across the nation—and you are complaining about it both ways—you tie up 20 per cent of capacity when it is not necessary. I do not think you should write that off as lost income.

The Chairman: Senator Carter, what are you suggesting, that he should aim for 100 per cent rental right away at lower rates?

Senator Carter: Yes.

The Chairman: Why?

Senator Carter: Because his total investment is wrapped up in the hundred apartments and he should recover it on that basis and not on the 80 per cent that he is going to rent right off because people cannot afford the rents and keep that other 20 per cent vacant for two or three years when people are looking for housing. I think the Government should discourage it, and if the White Paper discourages it I am on the side of the White Paper.

Senator Phillips (Rigaud): Senator Carter, with the greatest respect, is misreading what the paragraph says. There is no other indication here that a builder may not rent 20 per cent. He says that "a company which constructs a new apartment building may experience a high vacancy rate". We must not go into a theoretical assumption here that a builder deliberately put up more buildings than he thinks he can rent in order to hold out for higher rental income.

The Chairman: I think there is an assumption too Senator Carter is making that it is not your plan to rent 100 per cent.

Senator Phillips (Rigaud): Exactly.

The Chairman: Of course, I would think any person who builds an apartment would like to rent all the apartments right away.

Senator Phillips (Rigaud): The brief simply says he "May experience a vacancy rate", and the senator reads into it an intent on the part of the apartment builder deliberately to keep a percentage of the construction vacant in order to get higher income.

Senator Carter: Mr. Chairman, I must defend myself here. I am speaking from experience, because you can go to any new apartment building in Ottawa...

Senator Phillips (Rigaud): But the experience is not related to the brief we are considering. This is a different matter.

Senator Carter: I am dealing with actuality. Where a new apartment is constructed about 20 per cent, or up to 20 per cent of that apartment building will remain vacant for a year, or sometimes longer. On page 11 it says:

> Under the White Paper proposals such a loss would not be deductible from other income.

I agree with the White Paper.

Mr. Dart: Could I turn that around to your example, whereby you suggest that the landlord should reduce his rents in the first two or three years to completely fill his building immediately? I would suggest he would then create a loss because his rental income is lower than what was anticipated to carry the building. That loss would not be deductible, because it would relate to CCA. However, a person in another industry bringing out a new product and selling it at a loss for the first two or three years would be allowed to deduct that loss from income gained through the sale of other product lines.

Senator Carter: I think he is entitled to a normal profit based on full occupancy, but not on the eight years. He has to wait for that particular income bracket.

Senator Beaubien: But if he brings the rates down he loses more on the whole building.

Senator Carter: Not if the rates are economical.

Mr. Stikeman: Gentlemen, much of the remainder of this brief has been dealt with by previous submissions. I do not think we need take up your time on such points as we have between pages 13 and 19. That is the question of tax on the sale of a principal residence, regarding which Mr. Magee, as others of this board, feels very strongly.

It has been very thoroughly covered by Mr. Vineberg for CAREB, and by others this morning.

The Chairman: It has been covered in many other briefs, all with the same conclusion.

Mr. Magee: May I reiterate that in addition to the principal residence the sale of any secondary home is important.

Mr. Nixon, the Leader of the Opposition in Ontario, recently stated that there are 320,000 cottages in Ontario alone. The mobility of the Canadian labour force will be restricted if it is decided that a summer cottage or farm of reasonable proportion is to be subject to capital gains on the transfer of jobs.

It is terribly important and the employee will be reluctant to move unless his employer compensates him for any loss or tax he may suffer in the disposition of that property.

The Chairman: The larger companies in many industries have a policy today under which they provide the money for the new residence in the area to which an employee is transferred.

They take over the responsibility of the home he is leaving at a fair value. If they realize more on the sale they pay him the difference.

Mr. Magee: I agree, but are they prepared to go further and take his summer cottage?

The Chairman: This is a question we have to consider. Do you think they should?

Mr. Magee: I think they should not; I do not think the sale of any residence should be taxed whatsoever.

Mr. Stikeman: That is referred to at pages 21 to 23 of our brief.

Senator Phillips (Rigaud): If you do not include individual homes, I assume you have to eliminate homesteads and farms on them.

Mr. Magee: The question rears its head with respect, for instance, to a person buying

a speculative farm on the outskirts of Toronto.

Senator Phillips (Rigaud): That is a different matter; it is a venture in trade.

Mr. Stikeman: If they are thinking of taxing what you suggested, only stocks, bonds, securities, and real property other than homes or homesteads.

Senator Phillips (Rigaud): Exactly, the totality in and the exemptions out.

Mr. Stikeman: They are bringing it in at only 50 per cent, so the 25 per cent rate in effect applies.

There is one other item at pages 32 and 33 which I do not think, from my reading of the reports to this committee, has been mentioned. That is the desirability to provide for set off of mortgage interest.

I will read it:

> Where a taxpayer sells his home and purchases another, he may often be in the position of having to accept a second mortgage on the sale of his first home and to borrow money on the security of a mortgage to purchase his second home. The Income Tax Act does not permit the taxpayer to offset interest paid to acquire a home to live in, as being a personal expense, against the income received from the mortgage given on the sale of the old home.

On page 33 we say:

> We regard the absence of mortgage interest setoff as inequitable, the more particularly since it is becoming increasingly acute in recent years with the substantial increase in mortgage interest rates. More home owners are forced to take back second mortgages in order to sell their homes. Purchasers seek to continue the favourable first mortgage interest rate but are not inclined to pay the very high second mortgage interest rate that would be demanded by a commercial lender. Thus he forces the vendor to take back a second mortgage at approximately the current first mortgage rate in order to sell the house. The vendor, however, is then forced to take the larger mortgage on the purchase of his new home.
>
> It is recommended that in these circumstances the taxpayer be permitted to deduct mortgage interest paid on the purchase of his new home to the extent of the interest received from the mortgage taken back on the sale of the first house.

The Chairman: You mean you want an offset.

Mr. Stikeman: Yes, that is all it is. If a man sells a $30,000 home and takes back a $25,000 mortgage at 5 per cent, buys a $30,000 home, he does not change his circumstances and he has to pay 10 per cent.

He has put up $5,000 in cash, is considerably worse off and out of pocket because he cannot set off the amount he pays in, and pays more to get the new home. He has changed his circumstances not at all. He may have been forced to move due to conditions quite beyond his control.

The low rate of corporate tax has been covered *ad nauseam*.

The Chairman: That is right. However, it is not *ad nauseam* with us; we consider it as a serious problem.

Mr. Stikeman: So do we, but I was thinking of the repetition.

Senator Molson: You support the low rate.

Mr. Stikeman: We support the low rate and we again cite Mr. Robert Bourassa in support of it, particularly for Quebec.

The Chairman: We are ahead of him with respect to that we had those ideas much earlier than Mr. Bourassa's report was published.

Mr. Stikeman: I am just quoting him because it is St. Jean Baptiste Day.

Senator Phillips (Rigaud): Although we have no political affiliations in this committee, I am glad you quoted him.

Mr. Stikeman: I commend pages 36, 37 and 38 to your reading. We feel that the interest of foreign investment in Canadian real estate is of prime value to this country. However, it is being driven out now by virtue of the overhanging provisions of the White Paper. Should they become law much of that investment will vanish.

We all know that from our personal experience, not only on this side of the table but on yours. It has been the subject of many submissions.

I can only assume that you feel as strongly as we that the provisions of the White Paper which tend to discriminate against the foreign investor should be removed absolutely.

We have set out the feelings of this committee pretty thoroughly on pages 35 to the middle of 38.

We also hope in this connection that the new legislation will continue the present exemption, which was introducd in April, 1966, for interest paid to non-residents on NHA loans. That interest of 10 per cent to $10\frac{1}{2}$ per cent is a very attractive investment for foreign money. If it is proposed to remove the exemption we will dry up a very large source of capital for the most fundamental needs of housing in this country.

We will pass over the section on taxation of capital increment of emigrants, although we fell very strongly about it.

We accept and endorse the Quebec position on capital gains tax which, I take it, is really a replay of the feelings of many of this committee. We do, however, wish to state strongly for the record that in the event that a capital gains tax in any form or to any degree is introduced, there should be a corresponding, and preferably, a total elimination of the estate tax. We do not think there is any room for these two impositions.

We rather feel that in the long run since the capital gains tax may come in whether we like it or not, it is a better form of universal taxation and it will raise more money at less burdensome moments in a person's life than the imposition of a great load of first-class debt, which it is what it really is, upon death that has to be borne by an inexperienced widow or less concerned executives.

Senator Phillips (Rigaud): I suppose you want us to get our report in as quickly as possible and before the commercial rate on money goes down to 6 per cent. A great many of your representations are based upon the high cost of money.

Mr. Stikeman: That is right.

The Chairman: It is going to be a race against time.

Mr. Stikeman: We only make $50 million out of the estate tax anyway.

I have nothing left but the expense accounts. I do not know whether the committee feels that that warrants our taking up your time further. I am referring to the entertainement and convention expenses which in this case are not entertainment or convention expenses; they are education expenses.

The Chairman: That is something of which we are fully aware.

Mr. Strikeman: Unless my clients have anything further to say, that is our submission. I am afraid I have monopolized the discussion, but I have done so in the interest of speed.

Mr. Magee: I should like to say something, Mr. Chairman, through you to Senator Phillips. I gathered that he did not think that we should deal with capital cost allowance because we did not know what was going to happen. But, I feel, since the estate tax and the gift tax have been brought into law, and now we have this suggestion in the White Paper, and this fear hanging over our heads, about a change in the capital cost allowance, that they really should be considered as part and parcel of the same thing. If we are going to do away with the estate tax and have a capital gains tax, then that is part and parcel of the same thing.

Senator Phillips (Rigaud): I do not want to be misunderstood. I am in agreement with you, but this committee cannot deal with that subject matter because it is not before it.

The Chairman: Mr. Magee, have you a study of capital cost allowances which shows how you support one rate as against another?

Mr. Magee: I am inclined to agree, Mr. Chairman, with the submission that you have heard from the trust companies. We are far too young a country to be embarking on this course of action.

The Chairman: I am referring to capital cost allowances.

Mr. Magee: Well, all I could reiterate there is the question that Mr. Stikeman brought out in his report that the capital cost allowance brough in by Mr. Scully has served this country well over the years, and the minister considers it to be a loophole...

The Chairman: I am not looking at it from that aspect. I am looking at it from the aspect that it is too high, and should be reduced.

Mr. Magee: I do not think it should be reuced, sir.

The Chairman: I am asking if you have a study which supports the present rates?

Mr. Magee: No, we have not got a study *per se*, but all you can say is that if you

reduce it then you are going to increase the rental of accommodation across the country.

Mr. Stikeman: Mr. Chairman, upon leaving I would like to present you with a study that we have, and which may be of assistance to your senior adviser. It is entitled "House Price Trends and Residential Construction Costs in Metropolitan Toronto and across Canada." This is imposing a great burden upon the commmittee, but it might be helpful.

The Chairman: Thank you.

The committee adjourned until 2 p.m.

Upon resuming at 2.10 p.m.

Senator Lazarus Phillips (*Acting Chairman*) in the chair.

The Acting Chairman: Honourable senators, we are pleased to have with us this afternoon the Canadian Institute of Public Real Estate Companies. Mr. James Soden, Q.C. of Montreal, President of the Trizec Corporation, which owns the Place Ville Marie complex, will introduce the members of the delegation and make the first presentation.

Mr. James Soden, (President, Trizec Corporaiion), Canadian Institute of Public Real Estate Companies: Thank you, Mr. Chairman and honourable senators. On my far right is Mr. Patrick Kelly, President of the Canadian Interurban Properties and Executive Vice-President of Campeau Corporation. On my immediate right is Mr. Arthur Scace of the legal firm of McCarthy and McCarthy, who is counsel to our institute.

Before making brief opening remarks to our submission, I should like to mention a few words about our institute. I think it might be helpful to you.

The Canadian Institute of Public Real Estate Companies was formed by a group of real estate investment and development companies which are listed on the Canadian stock exchanges with the primary objective of acting as a representative body in relations with governmental authorities, securities commissions, other regulartory authorities and the public at large.

The members of the institute feel that with the growing number of companies in the real estate field which have become public companies in the last few years, there is a special need for the investing public and regulatory bodies as a whole to have a better understanding of the nature of the real estate industry and to have information made available on a meaningful and consistent basis.

The membership of our institute is na ional in its scope and covers all aspects of the real estate industry including land development, residential construction as well as developments of office and industrial buildings. Among our present membership we have assets in excess of $1.5 billion and provide employment for many thousands of people directly and in the industries to which they are related.

In pursuance of our objectives we have, among other things, now prepared the brief which we have the privilege of submitting to you today and we have also established a uniform accounting practices committee which will develop standards of accounting treatment after detailed review with securities commissions and other associations such as the Canadian Institute of Chartered Accountants.

I would like to say that the emphasis of the brief that we are submitting today is intended to reflect what we consider to be the most vital and important effect upon our industry of the proposed tax reforms. Our membership is quite diverse and we determined that we would not take up your time with the many points which individually have already been submitted to you in these separate briefs by some of our member companies, including my own and that of Campeau Corporation and others. We wish to emphasize today the singular point, that our industry is terribly dependent upon working capital and funds. It is referred to as a capital intensive industry.

We heard this morning that the development of housing starts and the development of projects has slowed down substantially, housing starts being down 43 per cent. This, of course, is a reflection of the present tight money market; tight money produces higher interest rates, and higher interest rates make it uneconomic and impracticable for developers to proceed as vigorously as they might wish, or the economy or the public might require.

We have been meeting this challenge, however, for many years. We have had difficulty in achieving all the funds we have needed for our purposes, and what we say to you today is that if certain aspects of this White Paper are legislated in their present form they will have a most material and adverse effect upon our industry, to the point that we will not be able to cope, and not be able to begin to

provide the housing, accommodation and space that is now in very short supply.

The White Paper, I am sure, does not intentionally try to single out real estate companies, but in the process of putting together its various provisions it has managed to have this compound effect upon our industry as such. The feature of the White Paper referred to as, I believe, integration has a compound effect upon our industry. We have in our search for capital had to look to equity financing more and more as the mortgage market was not able to provide for the need. It is for this reason that so many real estate companies in the last five or ten years became public.

If the proposals in the White Paper were to be implemented, there would be an increase of investment undoubtedly in equities, but not in real estate equities, because of the shelter that we have to have and are dependent upon to our capital cost allowance system for our day to day survival; we would not be in a position to offer the advantages of creditable taxes to equity investors. We will therefore lose on the equity investor side of the ledger. Also, where we are very dependent upon loan capital we will find that the supply of loan capital will be substantially reduced as more of this is put into more attractive equities.

In addition, the real estate industry has always had to look to foreign investment loan capital to enable it to carry out its programs, and the provisions of the White Paper, prospectively increasing the withholding tax, would have material and adverse effect upon this source of funds. In fact, it has already done so. The point has been made to you before that the longer this proposed leglation remains up in the air the greater the adverse effect will be, and we are feeling it today; we are in period of suspense in consequence.

The point that we make also in terms of the most serious impact upon our available working capital is the proposed attack upon capital cost allowances as it affects our particular industry. I say proposed, because we are not abundantly clear that it is exactly what is proposed, but it is clear that Mr. Benson intends in his proposals to reduce this shelter upon which our industry is dependent. I think it should be abundantly clear to you that if the total balance of our real estate industry is today dependent upon the capital cost allowances that we have had to rely upon to enable us to have a cash flow on a continuing basis to plough back into new investments and new developments, anything that is done to disturb or reduce this sort of funding will only add to the overall adverse effects.

We wish to make this one emphasis through our brief to you today. Mr. Scace is available to go through the instant points. Mr. Kelly and I are most happy to answer any questions you might wish to put to us. But we have observed in reading your proceeedings and during the course of our visit this morning that most of the points have been presented to you, that you are very familiar with them, and we do not wish to take up your time by repeating the same arguments. We just want to make the emphasis to you that out institute, representative of this collective group of real estate companies, recognizes that the overriding problem that results in our industry, from the White Paper, is its impact upon our sources of financing and working capital, which would have a very adverse effect upon us generally.

Would it be your wish, Mr. Chairman, that our counsel address himself to these two points?

The Acting Chairman: We will come to that. Thank you Mr. Soden.
Am I right in saying that this newly organized institute, in terms of assets, represents the largest organized grouping of real estate companies in Canada at the present time?

Mr. Soden: Yes, I believe it does.

The Acting Chairman: And you said the total asset value of the constituent companies was a billion and how much?

Mr. Soden: $1\frac{1}{2}$ billion.

The Acting Chairman: At least, that gives us the background. You stated that the Honourable Mr. Benson has indicated a proposed revision in the capital cost allowance. We dealt with that this morning, because it has not yet been indicated. But am I not right that, so far as reference in Article 5.17 of the White Paper is concerned, it is a statement of intent with respect at least to the specific items mentioned therein, that is to say, with regard to the total in cost being restricted to $50,000 or so.

Mr. Soden: Yes, Mr. Chairman, that is true, although I must say that it is one of the less articulate sections of the White Paper, because there is the aspect of article 5.17

where reference is made to the possibility of reducing the rates—which, of course, is a separate matter, and we would naturally wish to submit a brief in due course if any such consideration were to be made.

The Acting Chairman: Of course, that is right.

Mr. Soden: As regards the actual proposals, we are dependent upon the pooling system to enable us to generate the working capital, tax free working capital, that results from this pooling system. If the pooling system is taken away, it means that we will have fewer funds with which to carry on our work and since other sources of financing are minimal today, then this can only be the final straw that would break our back.

The Acting Chairman: That is the point that I would like you to develop with your associate, Mr. Scace, and so on. Do you concur with what was said to us this morning, that if a proposed negative income, the pooling, were to take place, as contemplated by Article 5.17, it simply would close the source of private investment and have the effect of increasing tenant rental?

Mr. Arthur Scace, Canadian Institute of Public Real Estate Companies: I certainly think, Mr. Chairman, that if you categorize it as a loophole, I am not sure of that, the fact that this tax advantage has existed, has meant that a lot of people have invested in real property who might otherwise not have done so. I cannot give figures, but I suspect that that investment will be substantially curtailed.

I would like to add, going on from what Mr. Soden said, that even if you think there is a loophole with respect to individuals, we do not think that the pooling concept should apply to real estate companies. There is not loophole now in relation to real estate companies. That is clear. I do not know whether it was deliberate or unintentional, but if you read Article 5.17 it certainly gives the impression that real estate companies will come under that proposal. And I do not think that should happen.

Mr. Soden: This is the ambiguity to which I have made reference. If the object of the minister is to get at what he calls an abuse, or infers is an abuse, I am not prepared to debate that or support the argument either way. But is is like Mr. Kelly said, it is like cutting off the leg to get rid of the corn. That abuse, if such it is, or that problem can be dealt with in a variety of ways.

I noted your remarks this morning, Senator Phillips, where you suggest there should be a possibility of some special graduated tax. If I may take the opportunity, I would like to recognize Senator Beaubien's remarks earlier this morning, when he asked a question as regards existing buildings, existing properties and existing bases of depreciation in capital cost allowances.

We have avoided even addressing ourselves to that, Senator Beaubien, for fear it might even infer acceptance of any other variation. But it would be iniquitous if, having paid the price—and one does pay a price to buy these bases, and which one chooses to use or not use as one makes use of one's inventory—it would be iniquitous to think that any variation in present tax laws would take away from prior established capital cost bases.

We are saying that our industry, like every other industry, is entitled to its capital cost allowances. It should be able to take the benefit of these allowances against the stratum of its income. We see no reason why our industry should be singled out. In fact, I do not believe it is the intention of the minister to single out our industry in any way. I think it was the intention, possibly, to get at private investment; and I say that this can be dealt with in many, many ways. I do not wish to be taken as being for or against the proposition in so far as it concerns invididuals.

Mr. Kelly, would you care to add to this most important subject?

The Acting Chairman: On the basis arrangement, as far as Article 5.17 is concerned, you say it definitely should not apply to real estate companies as such, and certainly not to public real estate companies. Secondly, at the very worst, that it should not apply to existing assets owned by real estate companies?

Mr. Soden: That is right.

The Acting Chairman: Is that it?

Mr. Scace: That is exactly correct.

The Acting Chairman: Would you like to develop that point any further, or do you think that is it?

Mr. P. Kelly, Canadian Institute of Public Real Estate Companies: I think that covers it, Mr. Chairman. I would like to point to the word "allowance". I would say briefly that

there are all kinds of analogy through our whole system. This is an allowance. It is sometimes mixed up with the use of the word "depreciation" and related to life of buildings and so on. I hope no one is thinking that this is one of the bases on which they make an adjustment. By analogy, our industry seems to be somewhat picked out and discriminated against; but our whole system of taxation in the country relates to "allowances". There are allowances to the dairy industry, there are allowances to the automobile industry, there are allowances to the mining industry, in some form—call them subsidies or call them what you will.

This to us is a form of internal generation of capital and we certainly take the effects of this into account when we relate the economics of a project.

The Acting Chairman: In any event, are you not subject to recapture?

Mr. Kelly: It is absolutely subject to recapture. This is just an allowance, it is only a deferral of something. It is something that is not being lost to the Government or being lost to the tax authorities. It is providing a generating vehicle, to produce an awful lot of housing and an awful lot of accommodation in this country, to companies like ourselves who build a considerable amount of it.

This is one of the factors we have to consider. It is not different from any other type of incentive which is granted. The Government grants tax incentives to industry to locate in certain areas. They grant forgiveable loans, they grant all kinds of things to stimulate. If they want to de-stimulate housing, this is a very good way of doing it. If they want to stimulate it, they should leave it alone. And I think in Sweden, where their capital cost allowances were studied considerably, it is even higher than ours. They found that when it was analysed, it was less than the reproduction of capital assets, when you tried to replace them.

Th Acting Chairman: I take it, before we leave that subject, that, obviously if by any chance capital cost allowances were reduced, the rental consequence will be the same as that indicated this morning in the brief presented to us.

Mr. Kelly: If it were 10 per cent we could give lower rentals, and if it were 15 per cent we could give still lower rentals. If it is reduced to 2 per cent, there will be higher rentals.

The Acting Chairman: So, in effect, the capital cost allowance is merely a deferment in your case. If it were disallowed either in whole or in part it would simply be added on to the cost of the project by way of increased rentals.

Mr. Kelly: There is more than that to it, senator. It would cause people like ourselves to considerably temper their thinking in undertaking a new project, because when they undertake a project, let us say, a 400- or 500-apartment unit, we have to allow a certain time for rental through the normal pick-up in the market. We also have to carry this uneconomical situation sometimes in the initial stages.

This is all part of the financing economics that make it work. If it will not work we will not build the unit, because our mortgage companies and our bankers are not interested in uneconomic propositions.

The Acting Chairman: Are there any questions on this particular point?

Senator Isnor: What is the amount, percentagewise of the flow-back?

Mr. Kelly: Pardon, sir?

Senator Isnor: You mentioned flow-back. You mentioned you must have flow-back.

Mr. Kelly: Do you mean cash flow?

Senator Isnor: Yes.

Mr. Kelly: Very well. I think our industry right now statistically—I would say our return on equity—if anybody thinks it is generous—investment is about 7.7 and a half per cent based on equity of all the top real estate companies in the country.

I have statistics here involving 11 of the top real estae companies in the country and our average return on net earnings available for distribution is 7.6 per cent and it is 6.7 per cent on equity.

The Acting Chairman: Are you reading from your brief?

Mr. Kelly: No. I am reading from a brief that was not filed with this committee. It happened to be our corporation. I am just using it for a reference.

Our return for all the top companies in the country is 6.7 per cent on equity and 7.6 on net earned.

Senator Isnor: That is a net return. You said you must have a flow-back on the Government allowances.

Mr. Kelly: Yes, sir. In this respect this is considered in that calculation. This deferred tax situation is considered. What I am saying is that this capital loss allowance which is now given to real estate in one of the factors or one of the elements which is considered when you set out to determine the economics of a project and it becomes an add-in which will reflect on the economics in that you defer that tax.

Therefore you are not in that required paying position in the earlier years of the project. Ultimately it catches up to you if you stop and ultimately you end up paying these full taxes.

It is an incentive towards expansion to building and building and developing more housing.

Senator Isnor: What I had in mind was what percentage rate would you expect that as an incentive?

Mr. Kelly: I am content to stay with 5 per cent. If you want lower rent or lower cost of units—if it were higher it would reflect it that 5 per cent. That is what it is now.

I mean, we have accepted that. I could sit here and say that I would like 10 per cent but I think the 5 per cent is something we have lived with and something that we have reckoned with for a considerable amount of time. I do not have to tell you how high rents are or how difficult the housing situation is right now even on that basis.

Senator Isnor: You do not need to tell me how high rents are. I think we all know.

Mr. Soden: I am not sure we have understood your question, senator. Are we giving you the answer you would like to have?

Senator Isnor: Well, if it is the 5 percent withholding that you want from the Government that is the answer, but I am not sure that is what you mean.

Mr. Soden: That is the present rate, senator. What we are saying is that—to put it in very simple terms—we heard this morning that the consequence of a 3 or 4 per cent rise in mortgage interest rates in the past three years is reflected, depending upon the size of the rental unit, in terms of a $30 or $40 per month increase in rentals, just in consequence in the rise in interest rates.

We have also overheard in other papers this morning that the cost of construction over the past three years has averaged 6 per cent a year at least. That is about 18 to 20 per cent increase in the cost of construction which has a not dissimilar monetary impact on the monthly rental of tenants.

If you take away from the real estate industry the funds that it is able to make use of by a capital cost allowance, which means that these funds are at least not paid to the Government to the extent of a 50 per cent tax and are available, it means we have to borrow less from the lending sources at these high rates with the consequence that we can make today's rental, as high as they are, continue to be available, but if you remove that source of funds, which we have already had, we would have to look at a whole new ball game.

Senator Isnor: In other words the rents will go up still higher.

Mr. Soden: Very much so. It will have to come from somewhere.

Senator Smith: Just to clarify one thing. Would you please give me the reference in the White Paper which will do what you say is so bad? I would like to read it and I have not got it with me now.

Mr. Scace: There are two references, senator. One is section 5.17 which sets up separate depreciation clauses for all buildings of over $50,000 and secondly—I do not know whether I can give you the exact reference, the suggestion is made that the capital cost allowance will be considered at a later date but the inference is there that it could be lower.

I can give it to you after we are through, if you like.

The Acting Chairman: There is a reference in the White Paper, senator, under the second point that the matter will be subject to further review and the implication is that the likelihood is the intention to reduce the capital cost allowance otherwise the warning would not have been given in the White Paper.

Senator Smith: I thought it was given as a warning.

Mr. Scace: Senator, it starts at section 5.11 and goes on.

The Acting Chairman: Are there any further questions under the heading of capital

cost allowances, honourable senators? If not may we proceed to the second part of your brief which is basic, and that is capital gains and integration.

Now, we have had a number of submissions on the whole question of integration. I think the best way of handling that is to ask a question from you gentlemen.

After a study of the proposed integration system, are you in favour of the proposed integration system as covered by the White Paper and will it be helpful to your industry if implemented or harmful?

Mr. Soden: As regards our industry, Mr. Chairman, it would be excessively harmful.

The Acting Chairman: Excessively harmful.

Mr. Soden: Yes. We have just made the point, Mr. Chairman, that we are dependent upon capital cost allowances so I shall not return to that but if one assumes that that is a necessary base and we use it to shelter or—I think Mr. Kelly's word is a preferable word—to defer our taxes then we will not be in a position to offer shareholders of public real estate companies the creditable tax advantages that shareholders of other public companies would undoubtedly enjoy.

This means that a very vital source of financing, an ever-increasing source of financing to our industry, namely, equity funding, will fall ito disfavour and we shall not be able to look to it as we have looked to it in the past several years. Furthermore, it goes without saying, that as equities of other than real estate public companies are made more attractive, there will be more and more pension funds and institutional lenders putting money into different forms of investment as opposed to making it available for mortgage or other forms of loan financing, on which we are also dependent. So we would be hit twice by the effect of this arrangement on creditable tax. We have a formula in our brief which I would ask Mr. Scace to explain. He has explained to me twice now, and it is rather difficult. So would you explain what we feel, Mr. Scace, would be an acceptable solution or alternative basis for us in this respect.

The Acting Chairman: Before we get to that, Mr. Scace, I think it would be desirable to get before honourable senators this basic point; as I understand it, in your industry the cost of construction is mainly financed by long-term funded debt, and in the process of long-term funded debt involving the amortization of the debt in due course, your dividend policy with respect to earnings necessarily must be restricted, and therefore under the proposed integration system you will not have a sufficient creditable tax available based upon the corporate tax paid, when you tie that in with capital cost allowance, in order to make the investments attractive to equity shareholders. Is that correct?

Mr. Scace: That is right, Mr. Chairman. As we have endeavoured to illustrate on page 9, I think it is a fair assumption to say that most or many public real estate companies will not have any creditable tax, and if you look at the last line of the table, it appears to us, given our assumptions, that the imposition of capital gains tax and integration will reduce the net after-tax yield on shares of widely-held public companies other than real estate companies by about 15 per cent, and in the case of real estate companies, it will be 27 per cent, so there will be a gap of 12 per cent between the treatment received by companies not having creditable tax and other public companies.

I might say this; this illustration is based on the assumption in the Carter Report that the shareholder return on equity was approximately 40 per cent in the form of dividends and 60 per cent in the form of capital gain. Now, if that assumption is wrong, the figures will change somewhat, but I think it is a reasonable starting point. They have done a fair amount of research on it and it is a fair assumption to take their figures as being correct.

The Acting Chairman: On the assumption that we do have an integrated system, what is your suggestion?

Mr. Scace: There are two possibilities, senator. First of all you could treat a distribution out of non-creditable tax as a capital gain, and if you did that with a widely-held company, one-half of the gain would be recognized. In effect, assuming a maximum rate of 50 per cent, you would get an effective tax rate of 25 per cent which would put it on a par with other widely-held companies having creditable tax.

As another alternative, you could treat the dividend distribution as a return of capital. In fact, that is a better way of looking at it because by virtue of capital cost allowances, the company is receiving money if the assets are used up or put into new assets. So, in

effect, it can be viewed as a return of capital, and that return of capital would reduce the cost base of the share. For example, if you owned a share which on valuation day was worth $100, and you received a distribution out of non-creditable tax of $10, you would have a cost base of $90. At that point of time there would be no tax payable by the individual. However, if he ever sold his share and realized the capital gain on it subsequently, the capital gains tax would be imposed. Now we favour the latter system but I think either would be preferable to what the White Paper proposes.

The Acting Chairman: On the assumption that you do not have an integration system and that we do have a capital gains tax with a flat rate in a separate category, hve you any thoughts on that?

Mr. Scace: I think that would be fine. At least it would treat all public companies in the same way. If you abolish integration you are abolishing the depletion between closely-held and widely-held, and we would be treated in the same way, and I think that is all we are asking for. We are being treated unfairly here and that will militate against our going to the equity markets and raising capital.

The Acting Chairman: Well as you heard the Chairman of this committee say this morning, there seems to be a general impression that nobody like the 2½ year reference, the deemed to be valuation at the end of five years, the distinction between privately-held companies and publicly-held companies. Do you agree with the conclusion of a prior taxpayer that in the final analysis if these unsatisfactory features were eliminated, there would not be much left of the integration system?

Mr. Soden: Very much so.

The Acting Chairman: That is your conclusion by way of concurrence?

Mr. Scace: Yes.

The Acting Chairman: Now, unless you have something further to say on this particular phase—we have covered it so much in prior briefs—may we move on? I do not want to press you unduly, but I think that covers that. I would like to point out under withholding tax that in addition to what you say at page 15, representations have been made that with respect to interest income payable to non-residents that we might get more foreign capital into the country by way of invesment if we eliminated the 15 per cent withholding tax in respect of interest paid to non-residents, on the theory that there are a lot of recipient non-resident creditors who do not need the withholding tax credit. Do you think it would bring substantial money into your industry if that were done?

Mr. Soden: I have personal knowledge of several situations affecting my company directly in the last six months where had that been the case, substantial funds would have been available to me from European sources.

The Acting Chairman: By substantial funds, do you mean in terms of your large company millions and millions?

Mr. Soden: The instance I have in mind, Mr. Chairman, was a $30 million loan where the withholding tax made the difference.

The Acting Chairman: And the withholding tax made the difference on a $30 million loan to your personal knowledge?

Mr. Soden: Yes.

The Acting Chairman: Which you were not able to get?

Mr. Soden: That is right.

Senator Beaubien: Mr. Soden, if the withholding tax were cancelled on other than Government bonds, which do not bear the 15 per cent tax now, have you any idea of the loss to the federal Treasury?

Mr. Soden: I am afraid I don't. It was not part of this particular brief and I am not prepared on that subject.

Mr. Scace: Well, senator, I note from the White Paper that the higher withholding taxes on investment income by the fifth year would result in a plus of $5 million. Now, that is going to 25 per cent. It is a very difficult thing to calculate, but if the present rates are at 60 per cent of 25 per cent, you might guess that there is another $5 million to $10 million received from withholding tax. In fact I think it would be more than that because built into this is the assumption that they will renegotiate many tax treaties and extend the tax treaty network, but I do not think it is substantial just looking at the table on page 96 of the White Paper.

Senator Beaubien: But that withholding tax, Mr. Scace, would deal with all withholding tax on dividends too.

Mr. Scace: Yes, it would.

Senator Beaubien: But we are talking just now on corporation bonds.

Mr. Scace: You are right, senator.

Senator Beaubien: Would there be something in the fact that if company A is borrowing in the States and the American lender is going to suffer a 15 per cent withholding tax, would it not in a way cost the Canadian company a higher rate of interest to obtain that money?

Mr. Soden: Exactly so.

Senator Beaubien: Therefore the amount of interest that the Canadian company would pay would be payable before the corporation tax in Canada, and if it paid less money, the Canadian Government would benefit. Would not that be right?

Mr. Soden: That is right.

Senator Beaubien: So in fact it might be a comparatively small loss if the Government did away with the withholding tax. Does that make sense?

Mr. Soden: It seems to follow, senator, but I must admit you are ahead of me.

The Acting Chairman: The senator is pointing out that if the withholding tax on interest were eliminated, it is likely that the foreign vendor would be getting a higher rate on his hypotheque or corporate bond, and in the process, interest being deductible under our law, it would work the other way and would probably reduce the profit to the Canadian company.

Mr. Soden: I think it would work the other way, Senator Beaubien.

Senator Beaubien: No, it would increase profits. Suppose I want to borrow $5 million and I have to pay in the States 10 per cent because the Canadian Government is going to take 15 per cent of all the money over that. Therefore, I have to pay 10 per cent on the loan, but if the Canadian Government were to do away with its share, then I could float the loan at 8½ per cent. If I do float it at 8½ per cent my profits are higher and the Government is the senior partner and gets 51 per cent of the profits.

The Acting Chairman: I would say: Go to the top of the class, Senator Beaubien; you are absolutely right on that. The loss of withholding tax on interest would be offset by increased corporate income.

Senator Beaubien: By the fact that the profits would be higher and they would get a bigger share.

The Acting Chairman: That is quite right. Is there anything more on this item, honourable senators?

Now consolidated tax returns. We have had overwhelming support for consolidated tax returns. Have you anything further to add to that, in the sense that you need it for your line of business?

Mr. Soden: Only this, Mr. Chairman, that it is the nature of our business that we cannot consolidate our construction. We have to do buildings in separate geographic areas, and we have to finance them within the framework of the separate identities of these developments, and the participations which are necessary to enable us to finance these constructions all lend themselves to the setting up of separate entities for the purpose.

From the standpoint of corporate accounting, it is most obvious to our public shareholders on a consolidated basis, and not to have the advantage of consolidated tax returns, as other more integrated industries are naturally entitled to, to me is an anachronism.

The Acting Chairman: Have you not got the instance, say, if you go into a local area, that you may invite local residents or particular parties to be associated with you in a particular development in an area, and in that way ou would not have wholly-owned subsidiaries but merely controlled subsidiaries?

Mr. Soden: In fact, it is becoming a necessity to enable the local communities to have that degree of participation.

The Acting Chairman: I think, honourable senators, that is a very important point because, obviously, in the expansion of metropolitan and other areas in our country the attraction of local interest becomes a matter of vital importance in terms of public support, the opening up of roads, public facilities and the like, and in the real estate business generally it is not normal to have wholly-owned subsidiaries, but what you have are controlled subsidiaries with local participation, and hence consolidation becomes very important.

Honourable senators, are there any other questions? Gentlemen, have you overlooked anything you would like to state?

Mr. Kelly: Senator, I would like to say one thing in summing up as far as the developer is concerned. Our company builds a lot of housing and has built a considerable number of units and hopes to build a considerable number more. But there are two basic things in this White Paper that we, as developers, are vitally concerned about. One is the pooling concept, which we have talked about, and the other is the capital cost allowance.

What worries me in a lot of situations is that the draftsmen of legislation and the people putting it together—who are not, what I call, in the pit or in the pool room where the action is going on—tend sometimes to have narrower or confined views as to the ultimate result. They may view the fact that there is going to be more income here or more tax take here, but the jiggling that goes on through the system does not become apparent until the waves start going out. Then everybody gets up in arms.

We would open our books to anybody, and I have the records as to our returns on our equity and investments. All I am saying is that we are in a critical perid of housing and of housing construction, and we are not going to get any better by looking at it in a narrow concept.

I am just using this as an example, and it may not be a good one, but when they decided that there was more tax take from the insurance companies a couple of years ago there were a lot of complaints, of course, from insurance companies and so on, but there was a change in the tax situation. As a result, the borrowing capacity or ability of the developer now has been considerably constrained because the insurance company is making an adjustment for its different tax position, which was the source of our long-term funds when we went to build housing and build buildings. Some of them have gone into the development business openly because they, in turn want to protect their position. Others are saying to us, "Well, we want the land under that building," or, "We want a percentage of your gross or net." The result is that we are paying an awful lot for our money, more than what appears to be the effective interest rate. Ultimately, we end up paying a real penalty, and this reflects itself in the cost of that accommodation and in the cost of that rental space.

I say that when you make one tax adjustment here, we, as an industry, if we are going to survive, have to adjust and can only pass it on to the ultimate consumer. We cannot absorb very much on 6.7 per cent on equity. I might better buy a Government of Canada bond, put the thing in the bank and sit there with a pair of scissors.

The Acting Chairman: Do you not have the case that some of the insurance companies are now asking for part of the equity in terms of actual share allotment, which again makes it necessary to have consolidation?

Mr. Kelly: Senator, we have given land out from under buildings; we have given percentages of gross; we have given percentages of net—we have given them everything but our shirt, and I am saying that a lot of this has come about as a result of adjustments in their thinking based on their tax jiggling which took place a couple of years ago. I am not saying there is not a basis for consideration of tax reform. All I am saying is that it is a good thing to take a good, hard look at it before somebody working in a closed room, with the blinds pulled, may think this is a great thing for getting taxes, but not seeing the ripples on the water.

The Acting Chairman: In other words, you are not the spoiled child of the economy of this country, are you?

Mr. Kelly: We certainly are not. As a matter of fact, when we walk out of the bankers' offices where we endorse the notes and out of the insurance company offices where we sign the contracts, we almost feel like we are just hammers and saws working for a lot of other people. There are many people paying an awful lot of high rent in this country and an awful lot more are going to be paying it if we do not have a good, careful consideration of the effect of this on our industry. We don't want to make a lot of money; we just want to survive.

The Acting Chairman: Thank you, Mr. Kelly. Are there any other questions you would like to put? I want to be sure you have covered everything. Thank you, gentlemen.

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: We shall consider now the submission of the Canadian Gas Association.

Mr. Wall is going to make the opening statement, and he will present his panel.

Mr. R. G. Wall, Vice-President and Treasurer, Trans Canada Pipe Lines Ltd.: Mr. Chairman and honourable senators, my name is Robert G. Wall. I am a member of the management committee of the Canadian Gas Association, and the vice president and treasurer of Trans Canada Pipe Lines.

Our panel today consists of Mr. Gerald E. Miller, Chairman of the Association's Taxation Committee and Controller of Union Gas Company of Canada ltd.; Mr. Mitchell H. Klein, of Phillips and Vineberg, our counsel; and Mr. Raymond Sim, who is also a member of the Association's Taxation Committee, and the supervisor of taxation for Trans Canada Pipe Lines Ltd.

We are very pleased to have the opportunity of expressing the Canadian Gas Association's views on the federal Government's White Paper, "Proposals for Tax Reform".

Basically, the association has eight points to make in its brief that is before you, and they are set out at pages iii to vi of the brief.

I know that each and every one of them have been presented to the honourable senators probably half a dozen times over, but I would like, with the permission of the chairman, to refer to two or three of them very briefly.

Basically, the association agrees with the general aims of tax reform as expressed in the White Paper. It is our conclusion, however, that the proposals fail to meet these desirable goals.

The proposed tax dividend system will act as an incentive to non-residents to purchase shares in expanding resource and utility companies by providing a higher yield to non-residents than it would to Canadians. Canadian equity financing of these companies under the proposals will become extremely difficult as Canadian investor emphasis will shift to the more mature, less rapidly expanding corporations which have fully creditable tax.

Incentives presently allowable, such as depletion cost allowances, which are necessary for the development of Canada and for the build-up of Canadian capital will be virtually eliminated by the integration proposal.

We would strongly urge that the present dividend tax credit system be retained as it provides an equal incentive for Canadians to invest in all-Canadian companies.

The tax on unrealized gains on public companies shares could force controlling Canadian shareholders to sell a part of their holdings. It would also create negative cash income factors for long term investors in new capital-intensive industries, and would compound the adverse effects of the dividend tax credit system on Canadian equity financing.

The Chairman: Do you mean the dividend creditable tax?

Mr. Wall: Yes, sir.

Canada must rely on outside capital for its development. To the extent that it is important that Canadians retain ownership of their resources and industry, it would be in Canada's interest if foreign debt capital, rather than foreign equity capital, is attracted. The removal of withholding taxes on debt interest—as was referred to in the preceding brief—which is really an insignificant source of tax revenue, would encourage additional investment by non-residents in debt securities.

Our economy, in order to provide for a greater share of the proceeds from our industries accruing to the benefit of Canadians, and in order to achieve continued prosperity must have a well-balanced and equitable tax system. It is our view that the White Paper Proposals fall far short of providing such a system. We hope that they will be rewritten to provide a tax system which will equitably benefit all Canadians and provide, to a greater extent, for Canadian ownership of our industries and resources.

Mr. Chairman, we are available to answer any questions you may wish to pose.

Mr. Chairman: Mr. Wall, you mentioned that the withholding tax on debt interest should be done away with because it provides an insignificant amount of the tax revenue. Have you any study to indicate what it might be?

Mr. Wall: Yes, sir, on page 11 of our brief we quote the federal Government's information which indicates that 2.02 per cent of their budgetary revenue in the year ending March 31, 1969 was received from withholding taxes from all sources, including interest dividends, rentals, and royalties. We do not have a breakdown of the amount applicable to debt securities.

The Chairman: Have you any guess-timate as to how much of the 2.02 per cent of total

budgetary revenue the withholding tax on interest might be?

Mr. Wall: Mr. Sim, have you any information on that?

Mr. R. Sim, Manager of Taxation, Trans Canada Pipe Lines Ltd.: Mr. Chairman, we do not have any specific figures, but we believe it to be in the neighbourhood of $35 million.

Mr. Wall: That is the amount that relates to interest.

Mr. Sim: Yes.

The Chairman: You have enumerated certain headings, Mr. Wall. We have been over these headings quite a number of times, but it is always possible that there is a new thought or idea. Have you anything to add in connection with the capital gains tax, for instance. You agree with what seems to be the general opinion expressed here by those who have appeared, that it should be a flat rate.

Mr. Wall: Yes, sir. Our association basically, I think, would prefer that there be no capital gains tax. We feel that we are a young country and we must attract extensive sums of money, and this is one of the incentives that can attract it. We have some views on it, though, if the decision is taken that a capital gains tax is inevitable.

The Chairman: Yes, it would appear that that is the conclusion of most of the people who have appeared before us, that it is a source of revenue that has not yet been tapped. I think that it will be tapped in some fashion. If you have some ideas as to how that tapping will be done, would you please indicate them?

Mr. Wall: I personally, as an individual, am impressed by the suggestion that came, I believe, from Senator Phillips, that in the initial stages only those gains realized from trading in shares, real estate, and businesses might be subject to tax. The association has come out and suggested that to the extent that there is a capital gains tax it should not be greater than 25 per cent. In fact, they suggest it might be lower than 25 per cent in order to be truly competitive with out neighbour to the south.

The Chairman: There is a great advantage in the capital gains tax. You do not have to consider exemptions, and things like that. These are specific items.

Mr. Wall: Yes, sir.

The Chairman: And therefore administration would be easier.

Mr. Wall: It would be easier, but I am sure you would find on the other side people would suggest if you specify those three there are others that really are capital gains of the same magnitude that have been specifically excluded. However, I am sure you would have the bulk of them in this.

The Chairman: If you just name the three that you mention and which Senator Phillips referred to this morning, you would not be providing any ground for the argument as to what the exemptions are. They just would not be included.

Then we have our general law in the courts and much jurisprudence as to what people have said are capital gains which have been ruled to be income by the courts.

Therefore we do not have to wrestle with that at all.

Senator Beaubien: You say you are concerned about the unrealized capital gains. Would you be a little more specific?

Mr. M. H. Klein, Counsel, The Canadian Gas Association: The Association is concerned and against it. The reason has been set forth by many other associations. It is that control could be lost. A forced sale in a given year could cause control to be surrendered. There might be a completely inequitable situation where, because of the proposed five year situation, a person's birthday happens to fall in a prime month and the stock might be depressed shortly thereafter. When he comes to sell he could realize substantially less than the amount he has been taxed upon.

The Chairman: Mr. Klein, it might also be in the 75 per cent-25 per cent situation where American companies have been given public participation for 25 per cent. They might find themselves in five years time having a revaluation of their 75 per cent interest, which they are not selling, yet they would have to find the money to pay a capital gains tax.

Mr. Klein: For which they receive no credit.

The Chairman: That is right.

Mr. Klein: This would also penalize foreign companies who, at the behest of the Canadian Government several years ago, made part of their securities available to Canadians.

The Chairman: They would have been better off if they had not given Canadian participation.

Mr. Klein: That is right.

The Chairman: You have a heading, "Natural Gas Exploration, Development and Production." This is in relation to the question of incentives.

Mr. Wall: Yes sir.

The Chairman: And the incentives you are referring to are the only ones available to the oil and gas industry, which are depletion?

Mr. Wall: Yes sir.

The Chairman: Without reading your brief, just tell us what you think about the White Paper proposal.

Mr. Wall: The Association's view is that in the first instance it is effectively retroactive legislation.

We have many thousands of investors who have invested moneys in the oil and gas natural resource companies, who did so on the basis that they were entitled to receive prospective allowances for depletion. The White Paper is introduced in a form in which it is proposed that form of depletion will not be available in the future.

The Chairman: First of all, no depletion is available to the shareholder under the White Paper.

Mr. Wall: That is correct.

The Chairman: And earned depletion is available to the company on a one-for-three basis. That is, they will allow you to earn $1 which you can keep and deduct from your taxable income if you spend $3.

What have you to say with respect to that?

Mr. G. E. Miller, Controller, The Canadian Gas Association: We prefer the recommendations of the Canadian Petroleum Association on depletion. They recommend that depletion should be a certain percentage of gross income from production. This system is more efficient than arriving at a depletion after deducting exploratory expenses.

They feel that the depletion incentive has to be maintained at as high a level as the present system, otherwise the development of our resources will be cut back. The cost of our gas in the field will continue to rise and this would be passed on to the consumer.

The Chairman: There are many objections to it, are there not? First of all, where is your market and with whom do you have to compete in the sale of your product? Is that in the United States?

Mr. Miller: We are competing in both the United States and Canada.

The Chairman: I am referring to the external market. The conditions under which you would have to compete in the external market would be conditions giving more favourable consideration to the oil and gas operators. Is that not correct?

Mr. Miller: That is quite right; the recent tax reforms in the United States provide greater incentives than are available under the White Paper.

Senator Beaubien: Mr. Miller, the changes you are suggesting, 20 per cent of gross, are roughly the American tax system.

The Chairman: I think we were told the American rate is about 21 per cent or 22 per cent.

Senator Beaubien: But it is on the same basis. You are suggesting a change from the present system to roughly that of the United States.

Mr. Miller: It is substantially the same, but it is a different system.

The Chairman: Gulf Oil suggested a 20 per cent depletion on the gross production income, then a one-for-two on earned depletion. I asked them the question whether that about equated to the present 33⅓ per cent of net production. They acknowledged that it came pretty close.

Mr. Miller: That is my understanding.

The Chairman: Would that sort of allocation within the area of depletion be satisfactory in your operation?

Mr. Miller: Yes, we endorse both recommendations.

The Chairman: You also say that the depletion allowance to the shareholder should be continued.

Mr. Wall: Mr. Chairman, the Association's brief is silent on that aspect. However, I agree that it is a depleting asset. We consider the philosophy of the theory to be sound.

The Chairman: I do not know how you cannot have a view with respect to that. If you give the company incentives such as you would with the unearned and earned depletion, it reduces the corporate tax of the company.

Mr. Wall: Yes sir.

The Chairman: Which reduces the amount of creditable tax. If we are going to increase through the shareholder not receiving the depletion nor the credit it is really giving with one hand and taking away with the other.

Mr. Wall: Assuming we are going to have depletion, I agree 100 per cent. However, I have not studied the other aspect.

The Chairman: In that regard the salvation of the shareholder and of the company would be not to integration. Therefore I take it your position is that you are against integration; is that correct?

Mr. Wall: Yes sir. With respect to the depletion aspect, as the members of the Canadian Gas Association are largely shareholders or distributors, they are concerned that it will have one or more of several effects. It will drive funds that might otherwise be available for investment in exploration away to other countries and/or increase the cost of the products which we transport and sell to the consumer in Canada and the United States. As we see it, it can only have that effect.

The Chairman: In other words, risk capital would not be available in the same measure.

Mr. Wall: Yes.

The Chairman: How do you evaluate the ratio between risk capital and debt? Is there a ratio that you attempt to observe?

Mr. Wall: Considering all utility members of the Canadian Gas Association, approximately 60 per cent is in the form of debt and 40 per cent in equity.

The newer transmission companies are more highly leveraged. They are perhaps as high as 70 per cent and 30 per cent.

The Chairman: If you were dependent for 40 per cent of your risk capital on the sale of the equity interest, then you must make those shares attractive.

Mr. Wall: Yes sir.

The Chairman: And you do not make them attractive if they get less in the way of net return than they would by investing in a mature company.

Mr. Wall: That is correct.

The Chairman: Is there anything more you wish to add with respect to integration? The integration proposals involve a number of things, such as the five year revaluation. Your view is against that. What about the limitation of two and a half years under which you may use your creditable tax on the pay-out of surplus.

Mr. Wall: We feel it is inequitable and administratively very difficult. Mr. Sim is knowledgeable on this. Have you anything to add to the two and a half year carry forward?

Mr. Sim: We generally feel that the rules imposed under the proposals are not compatible with an integration system. The rules for a two and a half year limitation and for a four-year reassessment of income, the allowance carry back and carry forward rule, will all complicate the problems that are already posed by integration.

The Chairman: Except the design of it may be to force out the payment of more dividends so as to produce more taxes. Is that right, Mr. Klein?

Mr. M. H. Klein: Yes Mr. Chairman. A company that has convenants under a trust deed which restricts its ability to pay dividends; could have entered into it over a period of five, ten or fifteen years, and they might be even prohibited from declaring these dividends, and their shareholders would suffer a tremendous loss by the forfeiture of that creditable tax after the two and a half year period. It has been suggested that stock dividends may cure the problem of the profit situation where cash was not available, but the provincial and federal governments frequently give supplementary letters patent to increase the preferred shares, for example; which takes time. These are all problems in addition to those already discussed.

The Chairman: Quite true. Have you any questions, Senator Beaubien?

Senator Beaubien: No, Mr. Chairman. We have covered this pretty well.

The Chairman: We have covered it pretty well. There is one question I was thinking of. Have you in prospect or in the mail any plans cthat will require additional risk capital that could be said to be marking time because of the proposals in the White Paper?

Mr. Wall: Well, this is an association.

The Chairman: When I say the Association, I mean your membership as you know it.

Mr. Wall: The association collectively has capital requirements of very large proportion, hundreds of millions of dollars in the immediate preceding years. The cloud that this White Paper has brought on each of us has forced some companies to defer their plans, and even change their plans. We are clearly against integration. Very simply, I see it as making it extremely difficult for us to raise equity capital in Canada. Similarly, by pushing the cost of the fixed interest obligation that we would raise in Canada to the extent that, if equity becomes more popular to the investing public in Canada because of the integration concept, the after tax yield will go up, and it follows, I believe, that the after tax yield on fixed interest obligations must likewise go up to be competitive. I think it is a matter of mathematics to prove that point.

The point the association makes is that most of its members are in the quickly expanding parts of their careers and that the equity will probably be purchased by non-residents, which is not one of the goals of the Government, and the fixed interest will become more expensive.

The Chairman: I noticed you have a heading here dealing with taxation of electric, gas or steam utilities. I suppose the strongest thing you could say is that you are against what the White Paper proposes.

Mr. Wall: I will ask Mr. Miller to speak to this specific point.

The Chairman: We had a field day here and heard most of these public utilities and they made a good case.

Mr. Wall: This relates to the 2 per cent lower tax applicable to certain utilities and not to the 95 per cent.

The Chairman: All right, go ahead Mr. Miller.

Mr. Miller: Mr. Senator, I cannot pass up the opportunity to emphasize that the submission we made some time ago was made at an earlier date because of the urgency. We have not seen an equity financing going in the gas distribution public utility industry since the White Paper proposals were handed down in November 1969, so we are very much concerned about the subject in the first brief.

The Chairman: Do you think it is the uncertainty as to what may result that is delaying those?

Mr. Miller: I think that is partly the answer and the result of the depressed market that makes the cost of equity capital very high, such a high dilution factor, but the White Paper is a very important adverse factor.

The section we are dealing with here, which Mr. Wall referred to, is the 2 per cent lower income corporation tax rate presently available to gas distribution utilities under section 85. This is something that was introduced about 20 years ago, at first at a higher rate than 2 per cent. I think it was 4 per cent. In doing our research we found that the Government said that since the expenditures of the public utilities are, to a great extent, non-discretionary and because we are controlled on our rates charged to the customers, and because we must keep pace with the growth of the economy, it was appropriate to have an incentive available to us. It is not clear in the White Paper whether or not we would lose the 2 per cent lower tax rate, but we are very concerned about the risk of losing it. The effect on Union Gas Company of the 2 per cent higher tax rate would be about $1 million in one year at the present time. We feel that this section should be continued. If we lose this 2 per cent lower tax rate it means that we will have to pass along $2 million in gas rates to our customers and similarly each gas distribution utility would have to pass along the increased tax through the customers.

The Chairman: It may be a fair assumption that 2 per cent will be lost because the White Paper seems to advocate a uniform and corporate rate of 50 per cent. One might normally assume that this is in the cards. It is 51 point something at the moment.

Senator Beaubien: Fifty-one point three. Are you paying an effective rate now of 49 per cent?

Mr. Miller: Two per cent lower.

Senator Beaubien: Forty-nine point three.

The Chairman: Are there any further questions on that point?

Senator Beaubien: If the industry was deemed to need a slight tax succession a few years ago it would seem extraordinary to increase it enormously now.

The Chairman: I think this came in when the Hon. Mr. Abbott was the Minister of Finance. As a matter of fact, I recall that I may have been the one who gave the explanation of the bill in the Senate. So these things come back to you. But, if it were needed then, the conditions have not changed to such an extent that they do not need it now. In any event, if you lose it, the rates will go up.

Mr. Miller: That is quite right.

The Chairman: I have passed over the question of depreciation for the moment, Mr. Wall. Is there anything you want to add? I know the White Paper says that they are going to review the capital cost allowances and it may be that they are too high. Have you any general comment on that?

Mr. Wall: I would ask Mr. Sim to comment on that point.

Mr. Sim: Mr. Chairman, we feel that capital cost allowances are necessary generally for the build up of capital within a company or within an industry.

The Chairman: The question is not whether there shall or shall not be capital cost allowances. The White Paper is suggesting that it may be they should be reviewed, because they may be too high. That is the angle on which I was wondering if you had any comment?

Mr. Sim: Yes, Mr. Chairman. We feel that they are not too high. We feel that the rates are presently acceptable to the development of capital within the industry.

The Chairman: Have you made any study of these rates?

Mr. Sim: No, we have not. We do not have specific studies as such. We certainly could supply figures on the build up of capital within certain companies.

The Chairman: Could you do this? It is quite obvious that is a source of cash flow.

Mr. Sim: Yes.

The Chairman: Then it really turns on how much the industry needs the cash flow, and needs a heavy or a heavier cash flow. It is that simple, is it not? The Government recognizes that has been the purpose, because in many cases, to encourage industry they grant accelerated depreciation.

Mr. Sim: That is true.

The Chairman: And in some cases where they give you a capital grant they permit you to depreciate the capital grant.

Mr. Sim: Yes.

The Chairman: Obviously it serves a very important purpose.

Mr. Sim: Mr. Chairman, I should like to make another point. On capital cost allowances, although they are generally higher rates than the rates of depreciation charged for book purposes, this will only occur in the initial years. Eventually, the actual amount of capital cost allowances will be below the depreciation charge, due to the accelerated rates. It is on a reducing balance system.

Senator Beaubien: Mr. Klein, have you any idea of how the American Government treats this?

Mr. Klein: On capital cost allowances?

Senator Beaubien: Yes.

Mr. Klein: I understand it is similar to what we have.

The Chairman: And, ratewise?

Mr. Klein: I cannot talk with authority about the rates but I understand it is similar. There are 24 different classes, and to take any individual one would be impossible.

The Chairman: In any event, with what you are enjoying now, you are able to live and compete. I am not talking about your competition with your competitors in Canada, I am talking about your competition outside. You have here "business expense and nothings".

Mr. Wall: Mr. Chairman, I think you have heard a great deal about business expense.

The Chairman: Yes. I am interested to hear if you have anything to say about the White Paper treatment of good will.

Mr. Wall: I do not know that we can add anything about good will, but you will find

that in the transmission and distribution companies within Canada, they have a large dollar amount of the so-called "nothings", which accountants have clearly determined as being expenses laid out to earn income but are specifically allowed by the tax department. Some of them have been listed on page 18. This is one of the few things we like about the White Paper—they propose to bring closer to the accounting concept the allowance of these things that heretofore have been treated as nothing. They are listed here as organization expenses, fees paid to underwriters for fund raising, discounts. This is a major item in respect to anybody who was borrowing in currency other than Canadian. They may borrow a dollar and it cost them a $1.05 to pay it back and that five cents is part and parcel of the cost of borrowing the money and as a result should be allowed as expenses, in our view.

The Chairman: Does anybody care to comment on goodwill? Is it a factor in your operation?

Mr. Wall: I cannot speak to that really. I do not think it is.

Mr. Klein: Mr. Chairman, if I may just mention one small point on the question of goodwill. This is a personal observation and it does not represent the views of the association in any formal way, but a lot of people have expressed some concern that goodwill on valuation day will not be valued. You have the rather unfortunate situation—for example—this does not apply to this association—but a fellow who on valuation day may have substantial goodwill and the day after a competitor comes in and starts a business and three years later, for example, the goodwill of the original entrepreneur might be down to next to nothing because of the new competition. Yet, if he sells his business at that time, he will be taxed maybe on the $5,000 of goodwill when the goodwill was $100,000 on valuation day.

Correspondingly, the fellow who opened up business the day after valuation day and sold his goodwill at that same time would not even be taxed on 100 per cent of the incremental value since valuation day because of the phasing in process.

The Chairman: That is in line with the criticism we have had that the treatment of goodwill under the White Paper will lead to retroactive taxation.

Mr. Klein: Correct.

The Chairman: There is no doubt about that. On the other items of business expenses the White Paper does not say anything in particular about them. It would appear logical if they mentioned them that they propose some method of treatment which I hope will not be as complicated as the treatment of goodwill.

Mr. Klein: No, I hope not.

Mr. Miller: Mr. Chairman, we are particularly concerned about the major importance with respect to right-of-ways.

The Chairman: Which?

Mr. Miller: Rights-of-ways. For accounting purposes it is typical to depreciate the right-of-way or amortize the cost of right-of-ways over a period comparable to the life of the pipeline or distribution pipeline or a transmission and yet for tax purposes if the right-of-way is perpetual it is a capital nothing and the White Paper is silent on this item.

I think we should have clarification on this point.

The Chairman: Well, what do you suggest? You give us some language.

Senator Beaubien: Mr. Miller, if the right-of-way is perpetual you do not show any value.

Mr. Miller: If the right-of-way is nominally perpetual for accounting purposes we will amortize the cost of the right-of-way using a life comparable to the life of the pipeline itself.

Senator Beaubien: What would that normally be for a pipeline? How many years, 20, 30 or 50 years?

Mr. Miller: It could be in that neighbourhood. It depends, according to the pipeline's source of supply. I would suggest that it should be a fairly simple system of permitting amortization over a period comparable to the life of the pipeline. Cost of use, class 2,6 per cent, would be appropriate.

The Chairman: So if you include the item in this section...

Mr. Miller: Class 2, 6 per cent.

The Chairman: Class 2, 6 per cent, that would be satisfactory to you?

Mr. Miller: Yes, I think so. It is roughly the same as we do in accounting purposes where

we amortize the cost over the life comparable to the life of the pipeline.

The Chairman: Do you have anything to add there?

Mr. Sim: There is a similar treatment now under the Income Tax Act, as I understand it, on the question of leasehold improvements where they are not put up by the owner but rather as a leasehold improvement, he is allowed to deduct them over the 40 years' life of the lease; so you would have the same kind of situation as here with rights-of-way. There is that example in the current Income Tax Act.

The Chairman: Yes.

Senator Isnor: What is the lifetime of a pipeline?

Mr. Wall: I refer to our own company, which is Trans Canada. The engineers' estimate is if it is kept in proper maintenance, it will last almost forever, perhaps 100 years.

Our own company has taken the position that we can see an economic life of 50 years' supply and therefore we are depreciating it effectively at 2 per cent per annum straight line for the remaining years.

In the case of other members of our association who are in the distribution business they likewise, I know, would depreciate their assets on the basis of the lesser of estimated useable life or economic life and I would think the economic life in the case of a pipeline is the one that would be followed through.

Senator Beaubien: Mr. Wall, do you include the cost within the right-of-way?

Mr. Wall: Oh, yes. There is no question but that the companies will be amortizing these right-of-way costs. The point of concern here is that they are not allowed as an expense in arriving at taxable income. In this brief we maintain they should be.

Mr. Miller: In addition I may point out typically the right-of-way would be of no value to the company when the pipeline is gone.

The Chairman: Yes. It will be difficult to use the area of the right-of-way for farming purposes. It is really only a long narrow strip.

Senator Beaubien: You can only use that pipeline on the right-of-way and if the pipeline is used no more, it is of no use.

The Chairman: It has no value. If you cannot use it for a pipeline then you are not going to be able to sell it to anybody else for a pipeline.

Senator Beaubien: Today cannot you charge that against the expenses?

Mr. Wall: We do amortize this, yes, but it is an item that is added back in in arriving at our taxable income under the present Income Tax Act for these companies which have reached the point where they have been assessed.

Senator Beaubien: In a way it is academic because you are not paying too much taxes.

The Chairman: No, but hope springs eternal.

Mr. Wall: We are deferring payment of taxes as permitted.

Mr. Miller: Mr. Chairman, I would like to speak to this point. When we tried to claim a deduction for amortization of a right-of-way of a distribution pipeline and contended that we should use the same life as the life of the pipeline because the right-of-way would be useless once the pipeline was gone, we were unsuccessful so the cost has not been allowed to our company or to our industry. Our taxes are higher accordingly than what we think they should be.

The Chairman: So you are paying taxes on money that has been laid out.

Mr. Miller: Yes, we are. Our rate of creditable tax would be quite high really. We have some deferrals but we are at a more mature stage in our company.

The Chairman: You have a heading here, "business expenses, entertainment and related expenses". I take it you do not fall into the category, that the White Paper makes, about having yachts for entertainment for your customers and things of that nature.

Mr. Wall: Mr. Chairman, not that I am aware of. Our position is the same as virtually everybody that appeared before you on this point. We consider collectively that the expenses which have been laid out to earn income should be allowed as a deduction, that the present Act provides for adequate control of abuses, and that with proper administration no change need be made. Mr. Klein is really experienced in this particular area and may have something to add.

The Chairman: Is it sections 11 and 12?

Mr. Klein: Section 12(2) of the present Act says that any expenses to be deductible must be reasonable. Quite frankly, in instances where this particular matter has come before the courts, the courts have been quite hard on the taxpayer who tried to expense a yacht, for example. Really it is a question of enforcement in trying to do away with a small amount of abuses and the White Paper would appear to penalize heavily an area of expense which is a valid expense by large corporations for employees to improve their knowledge of their particular fields.

Senator Laird: Mr. Klein, don't you find that the Department of National Revenue does a darned good job in checking things like that?

Mr. Klein: Our clients seem to feel that they do, yes, and I have to agree with that.

The Chairman: Now, going through these particular headings, Mr. Wall, are there other features you would like to put before us?

Mr. Wall: I think Mr. Chairman we have covered them all. The main thrust of our approach is that feel that the integration proposal is not a wise one. It will hurt the industries that are associated with natural resources, something that the country would like to continue to develop. We would urge you to seriously consider the recommendations that we have made here with respect to withholding tax. The policy of the Government of Canada and of this White Paper would appear to be—let us try and attract as much fixed interest foreign obligations as we can muster—and this withholding tax may be only a nuisance factor, but it is having an effect on companies raising funds in foreign countries.

I suppose everybody at this table has been exposed in just the last 12 months to the problem of European borrowings, and they just will not lend any money unless you indemnify them or hold them harmless with respect to withholding tax, and those borrowings from the United States are somewhat narrower because there is not as large a group that can take advantge of the credit. I think those are the two main thrusts of our proposal.

The Chairman: Thank you very much.

The Chairman: Now we have submission from the Canadian Association of Oilwell Drilling Contractors.

Mr. Porter is going to make the opening statement on behalf of the Association and will introduce the panel. If they have any feature points they wish to make they will do so. Then they are open for questions.

Senator Haig: Mr. Chairman, before we start, can Mr. Porter tell us what drilling mud is.

Mr. J. D. Porter, Executive Vice-President and General Manager, Canadian Association of Oilwell Drilling Contractors: Yes, sir, it is an additive that is put down the well for the purposes of (a) cooling the drilling bit and secondly to assist in breaking away some of the geological formations you are drilling through. It may be barite or various chemicals added to it. Diesel fuel is added to it at times.

Senator Beaubien: It is a lubricant, in fact, is it not?

Mr. Porter: It is a lubricant. It has several other uses too.

The Chairman: You mean in the drilling process?

Mr. Porter: That is right. It is basically to expedite the drilling performance.

The Chairman: Now, Mr. Porter, we are ready for you.

Mr. Porter: Thank you, sir. Mr. Chairman, members of the Standing Senate Committee on Banking, Trade and Commerce, on behalf of the Canadian Association of Oilwell Drilling Contractors, may I express our appreciation for the opportunity of appearing before you today to present the views of our members on the White Paper entitled "Proposals for Tax Reform". We recognize the significant responsibility of this committee in their review of the changes proposed in the Income Tax Act.

These opening remarks will consume approximately five minutes and thereafter we will be pleased to attempt to answer any questions which the members of the committee may choose to put forward.

The representatives of the association are: Mr. H. J. Irwin, on my far right, who is the President of the association and President of G. P. Drilling Ltd., Calgary; secondly, Mr. R. E. Sparrow, Director of the association and

President of Argus Drilling Limited. Next to Mr. Sparrow is Mr. H. G. Pearce, M.B.A., Advisor to the association; and on my immediate right is Mr. A G. Burton, F.C.A., also an Advisor to the association.

Our industry in Canada is Canadian—approximately 90 per cent of the companies operating drilling equipment and about 85 per cent of the service rig contractors are now Canadian-owned. This is a complete change from 1949 when the oilwell drilling industry in Canada was predominantly U.S.-owned. This change to Canadian ownership has been achieved under our existing tax laws.

The Association represents virtually 100 per cent of the oilwell drilling industry and approximately 85 per cent of the service rig contracting industry in Canada. The drilling and service rig industries are comprised of independent contractors who rely solely on the activity of the petroleum industry for their income.

Oilwell drilling and servicing is a highly specialized industry required solely for the purposes of petroleum exploration and development. In fact, a drilling rig is a highly mechanized, self-contained, mobile factory. Its sole function is to drill holes that will permit the recovery of oil or gas. Oil and gas wells are drilled on a 24-hour-per-day basis, to depths which range from 1,500 to 18,000 feet, or down to 3½ miles.

Our industry employs up to 6,500 people whose wages and salaries approximate $42 million per year. At other times, during peak seasons, we may employ up to 10,000 or 11,000 people, and in that circumstance our payroll and salaries would approximately $60 million. The value of Canadian goods and services annually purchased for rig operating supplies are in the order of $25 million. Additional services purchased in Canada would equal another $30-35 million.

The White Paper admits that implementation of its proposals will adversely affect the resource industries in Canada. Consequently, it will reduce overall economic activity in Canada. As a Canadian industry, which is totally dependent upon petroleum exploration, we are vitally concerned with the proposals contained in the White Paper. There is no alternative use for a drilling or service rig—except scrapiron.

Positive tax incentives will be required if the petroleum industry is to be able to attract adequate domestic and foreign capital to finance exploration and development expenditures, including the increasingly important but higher cost operations in the Canadian North. If the White Paper proposals are implemented, in our opinion, this new investment capital will not be forthcoming.

The members of this Association are not opposed to some modifications to the present Income Tax Act. We feel, however, that it is unrealistic for the authors of the White Paper to expect interested parties like ourselves to be able to recommend alternatives to specific proposals. Even the Federal Government and the Ontario Government, with all their resources, have been unable to produce a mutually acceptable document. A further weakness, and by its own admission, the White Paper refers to the risks of forecasting economic activity and revenues as noted in Section 8.5, on page 86.

It is a recommendation of this Association that "the only logical procedure is to retain the present Income Tax Act, modified gradually to incorporate reasonable changes acceptable to the taxpayer, business community, and governments". We believe this approach is reasonable and would eliminate existing uncertainty associated with the introduction of a totally new, untested tax reform bill, and would preserve the legal precedents established over a number of years.

As pointed out, we are a Canadian industry, owned by Canadians. It must be recognized that we are dependent upon the need for continued investment of foreign and domestic capital. Capital investment by the world oil industry can be expended anywhere—it is mobile—and if the Canadian tax climate is not competitive, we will wind up with a lot of idle drilling rigs, unemployed drillers and undeveloped hydrocarbon reserves in Canada.

Our business covers a large geographical area of Canada. We have operated from the Grand Banks of Newfoundland in the east to the Queen Charlotte Islands in British Columbia in the west, and from the most southerly point of Canada to almost the North Pole—to within 500 miles of it. Obviously such widespread areas of activity produce a tremendous strain on our human and financial facilities.

Mr. Chairman, we have told you and the members of your committee that within the past 21 years Canadians have essentially gained control of the oil well drilling industry in Canada. We are afraid that if the main proposals suggested in the White Paper

are implemented we Canadians may well lose our dominant position in this industry.

Mr. Chairman, our group will be very pleased to endeavour to answer any questions which you or your committee may wish to raise.

The Chairman: Mr. Porter, I have one for you right away.

Mr. Porter: Very good, sir.

The Chairman: You say that if the main proposals in the White Paper are implemented your industry is likely to be replaced by non-residents.

Mr. Porter: We think that that is likely.

The Chairman: Would you enumerate those main proposals that might have that effect?

Mr. Porter: First of all, sir, I would say that the philosophy, the integration concept, the capital gains tax, and the lack of incentives for the petroleum industry and private enterprise.

The Chairman: Let us take them in the order in which you have taken them. Perhaps the chief one is a toss-up between integration and the incentives.

Mr. Porter: Perhaps we could touch upon the philosophy first, and then we can lead into what follows.

The Chairman: Yes, if there is philosophy in the White Paper perhaps you will point it out to us.

Mr. Porter: I am going to ask Mr. Pearce to discuss what we conclude may be interpreted as the philosophy of the White Paper.

Senator Phillips (Rigaud): We had a witness yesterday who talked about philosophy. There must be something in the air.

The Chairman: Senator Phillips remarked yesterday about people who become philosophical, and what happens to them. There is a case in history of a philosopher who drank a cup of hemlock. So, beware!

Mr. G. F. Pearce, Adviser, Canadian Association of Oil Well Drilling Contractors: I am a little afraid to start out after those comments. The area that we would categorize as philosophy, which I would like to touch upon very briefly as a start, and which will overlap some of the comments to be made by other members of the panel later in our discussion, deals first with the subject of fairness and equity, and, secondly, the increasing shift in importance to the public sector of the White Paper taxation system if implemented, and then the fact that certain of the proposals seem to be contrary to established long-term government policies; the removal of certain incentives that we already have; and the fact that the authors of the White Paper seem to feel that the level of economic activity will be the same as under the present taxation system if this system is implemented.

The reason why I would like to comment very briefly on these points is to place in proper perspective the position of the drilling contractors. Dealing first of all with fairness and equity, there apparently has been no consideration given to the need to recognize risk in the definition of fairness and equity in the White Paper. As will be commented upon by other people on the panel...

The Chairman: Do you mean adequately recognized?

Mr. Pearce: I do not believe they recognize it at all.

The Chairman: Yes, they do. They say that the mining, oil and gas industries require special treatment. It is their assessment of them that we say is not adequate.

Mr. Pearce: Very well. My reference there was primarily to their discussion of fairness and equity in the initial part of the brief, and I was dealing primarily with the personal aspect as opposed to the corporate aspect. We need tax incentives if we are to attract the risk capital needed to develop the petroleum industry.

As indicated by Mr. Porter, we are 100 per cent dependent on the health of that industry for our livelihood. One of the other contractors here may wish to comment further on the aspect of unique risks facing the industry.

Dealing next with the fact of the increasing importance of the public sector under the White Paper there are certain proposals which will have this effect, such as the removal of the 21 per cent corporate tax rate, resulting in a shift of some tax to the public sector.

With respect to the capital gains tax proposal, we have all heard very much with regard to the variation in revenue projections made by the authors of the White Paper and by the Province of Ontario. Our concern here

is not that the public sector is not capable of handling funds given to them from the source of revenues. However, there are certain types of investments that they may not be as experienced in handling as those in the private sector, such as the high risk industries.

The Chairman: Is not the direction of public investment another factor? Once they have come into possession of the money they are likely to invest in areas entirely different from those which the private sector would use and would not add in the same way to economic growth.

Mr. Pearce: That is correct, Mr. Chairman. One relevant point is that if we are to develop the social programs in this country which we feel are necessary we must have healthy economic growth.

Moving now to the third point, some of the proposals seem to be contrary to established and long-standing Government policies.

It is evident that as individual taxpayers in the country increase their taxable income they will be exposed to substantially higher taxes under the proposed system. This seems to work against policies at all levels of Government to improve the education and training facilities in the country. It also hinders aid in financial and technical assistance for industry and business and our desire for increasing Canadian ownership of our resources.

Turning to the removal of incentives, which other panel members will discuss in more detail, one is the removal of the 21 per cent tax rate which is so important to high growth and particularly smaller companies just starting into their high growth period. This is emphasized by the difficulty of financing faced by many of these smaller companies, particularly those in the resource industries.

The second concern relates to the removal of incentives and the proposal to tax capital gains. The main point is that it will provide a relatively small source of revenue to the federal Government, as is admitted in the White Paper.

In our opinion this form of gain should be tax exempt in order that businessmen and private individuals will be encouraged to invest in the economy and stimulate our economic growth.

Moving very quickly to the comment made earlier to the previous group regarding expense account proposals, our feeling is—we have elaborated on it in the brief, so there is no need to comment on it too much at this point—we feel that proposal is too inflexible. It does not recognize the fact that legitimate methods of doing business differ from one industry to another. As we have identified in our brief, for drilling contractors the drilling business is a high specialized business, requiring different kinds of business expenses than perhaps the automobile or other industries.

We would also like to mention under this broad area of philosophy a general point on emigration. The White Paper expresses scepticism that tax factors have a major bearing on emigration. This may be true for the country as a whole, but we do not feel it is true for people involved in the drilling industry as a full time vocation or profession. They may be encouraged to emigrate for two reasons at least. One is the lower tax position in other countries, and also the fact that the profesionally trained and highly skilled people particularly will have no alternative; they will have to leave for other countries in order to obtain proper employment in the drilling industry.

I should like to comment later perhaps on economic activities, and perhaps I could just leave that at that point.

The Chairman: Now that we have moved through the philosophy, which from your recital does not appear to represent a logical progression, we can now move into the area of integration. I think we could deal with depletion at the same time. First of all, what is your position in relation to integration as proposed in the White Paper?

Mr. Porter: I would ask Mr. Burton to comment on that, if I may, Mr. Chairman.

Mr. A. G. Burton, Advisor to the Association, Canadian Association of Oilwell Drilling Contractors: I can start with a very short answer. The association is opposed to integration.

The Chairman: We have been hearing that from nearly everybody.

Mr. Burton: That is the sort of opposition that is made perfectly clear.

Senator Phillips (Rigaud): That is particularly fortunate coming from you and your firm in the light of certain circumstances.

Mr. Burton: Perhaps I might now go to some of the other points and elaborate a little further. First, it is necessary for us to talk about the petroleum industry. We are not representing the petroleum industry; we are

representing the drilling industry. However, as Mr. Porter said, there is only one thing you can do with a drilling rig, and that is to drill for oil or gas, and therefore if there is not a petroleum industry there is not a drilling industry. Obviously anything that affects the petroleum industry in a detrimental manner will in turn affect the number of drilling rigs employed and the drilling industry.

The Chairman: Perhaps you would stop right there. Mr. Porter said something earlier indicating that there may be some clash between the two statements. He said that if the proposals in the White Paper under these headings are implemented, your association and the membership in it might lose out to the non-resident ownership.

If you lose out because there is not a petroleum business, why would anybody else come in?

Mr. Burton: Really, sir, that is another question you are bringing up and something separate. May I come back to that one?

The Chairman: All right.

Mr. Burton: We feel that the depletion changes for the petroleum industry will have a definite effect on the moderate drilling that is done in Canada. It must be remembered very clearly that those who wrote the Carter Report completely missed the point that money used in the petroleum industry is petroleum money. The Carter Commission, for example, made the statement that they were not too sure that the money spent on the petroleum industry in Western Canada could not have been better spent elsewhere. But the facts of the matter are these: if that money had not been spent in the petroleum industry it would have not been spent in Canada; It would have been spent in Venezuela, the United States, Mexico, Indonesia, North Africa and many other places in the world.

Petroleum money is a special type of money and it flows all over the world, but it is only going to flow into petroleum and/or mining. There are certain links between the two.

Many of the large United States companies that do operate throughout the world have a gathering, usually by the end of the year, of their people from all over the world. They each bring in their budgets and add them up. If the total is more than they have got, they then look around to see which one is going to bring them the biggest return after tax. They then decide that is where they will put their money. One fellow gets shaved and the other one gets his budget.

Now, it is the after tax return that counts. It is important to remember that the words "after tax" are not restricted purely to income tax. They are applicable to all types of tax. In other words, there are areas in the world, particularly in the Arabian countries, where instead of having an income tax they just take a larger percentage of royalty. It is still the same thing. When they look at Canada they see that we have a certain depletion factor here. Up until the present time we have had what is known as a percentage depletion. They have percentage depletion in the United States. Therefore, people down in the States like the idea of the Canadian situation because it is a percentage depletion. I understand the major companies, and a lot of the individuals who come to Canada—believe me there are millions of dollars brought into this country by individuals—know that they will get a percentage depletion, but they do not recognize that in Canada you get no depletion until such time that you pay tax, whereas in the United States you get depletion for many years without paying tax.

Senator Beaubien: How would that work out?

Mr. Burton: Sir, they get their depletion on a gross basis. The current rate as mentioned earlier here today is 22 per cent of gross, and not to exceed 50 per cent of net income. They do it on a property-by-property basis. As soon as you start to produce from one property you will immediately get your depletion on that property. You do not have to pay any attention to the other properties, because each one is done individually. Some of the very wealthy individuals in the United States have built themselves up and literally paid practically no tax. I am not particularly advocating that, because I think the pendulum swung too far in that instance.

In Canada you must put all your expenses and all your revenues together. There have been companies who literally have extracted all the oil out of a field and have never yet ad five cents worth of depletion. Our depletion is based on taxable income only.

With the change in the White Paper whereby percentage depletion as such is going to be thrown out and instead you are going to have an earned depletion, this I am sure, from

conversations that I have had with people in the United States, is going to have quite a psychological impact. It is more psychological than anything else. They are used to percentage depletion so they feel they are going to get it in Canada and you turn around now and tell them they have got to earn their depletion and all of a sudden it does not look so good.

Senator Phillips (Rigaud): Is it more psychological than realistic in the result?

Mr. Burton: If you earn enough depletion, you can still get up to one-third of your taxable income, you can never get more; but you also know that the chances are that you will not earn that much, up to the one-third, for ever. Therefore, the new basis has to be less than the present basis. There is no way it can exceed it. It must be less.

I agree with your comment, actually, sir, that what will happen is, that people will look at us up here and say we are not going to get as much depletion as we had before, and therefore they will put their money into some other area.

On the United States tax rules, even for individuals, they can take all their drilling expenses against their ordinary income, whether it is from a business or profession or anything else, regardless of whether they spend the money in the United States or outside the United States.

We are different in Canada. We say you get no benefit if you spend it outside of Canada. But there is complete free flow of money as far as the United States citizens and corporations are concerned.

Obviously, we have to be opposed to any changes in the depletion allowance that are going to hurt the industry, because we feel there will be less money coming into Canada and, as I say, with less money you drill fewer holes and you have fewer drilling rigs.

The Chairman: What you are saying at this stage is that earned depletion is not a proper concept?

Mr. Burton: That is true. It really should be a gross depletion basis, somewhat similar to that of the United States and I think you have had previous representations on that.

The Chairman: Yes, and they agree that it should be a combination of earned and unearned depletion. Would you care to comment on that?

Mr. Burton: Yes, sir. There are some places, I understand, that do it. Australia had a situation somewhere along that line. I think that, in a combined factor like that, as long as you have what you call your unearned depletion, as a base to work on...

The Chairman: An oil company starts sometime, and it has to attract capital.

Mr. Burton: That is correct.

The Chairman: And, it being risk capital, even the White Paper recognizes that you need some incentives.

Mr. Burton: Yes, sir.

The Chairman: I regard an incentive as being something as a result of which you pay less tax.

Mr. Burton: That is correct.

The Chairman: I think that is the proper definition of it.

Mr. Burton: That is correct.

The Chairman: So, in order to get going, incentives have attracted the operation, and if you have unearned depletion as a continuing thing, then you are recognizing by that kind of incentive the special risk by which the whole operation got going.

Mr. Burton: That is correct. I agree with you on that, sir. In addition, I think the point I am trying to make is that we are competing for worldwide money and if our depletion situation in Canada is not comparable to other areas—let me turn it around the way I said it before—if the after tax return is not comparable, then that money will not come here.

The general estimates are, to keep the Canadian petroleum industry going, in the same manner as it has been in the past two or three years, and with the normal inflationary growth, it looks as though the industry will require approximately, pretty close to $20 billion in the next decade. That is based on the fact that a year ago they spent $1.2 billion; you multiply that by ten and add the inflationary factor. In addition to that, costs are going up, because now people are moving into the northwest areas, where it is far more expensive. It may even cost you half a million dollars to move a drilling rig, before you can start to drill.

The Chairman: And the Atlantic coast.

Mr. Burton: The Atlantic coast, and so on. So you have gone over a lot of your cheaper labs in Saskatchewan and now you are moving into the more expensive areas.

Senator Beaubien: What would a drilling rig cost?

Mr. Burton: The rig will vary from $250,000 to $1.5 million.

Senator Phillips (Rigaud): The cost of the rig itself?

Mr. Irwin: Yes. So you have quite a capital outlay.

Mr. R. E. Sparrow, Director, Canadian Association of Oilwell Drilling Contractors: The off-shore rig such as we have at the east coast may be in the order of $12 million to $15 million.

Senator Isnor: That would be the off-shore floating rig.

Mr. Sparrow: There was an oil drill at Sable Island that was about 15,000 feet long and that would cost approximately $900,000.

Mr. Porter: Senator, the rig which is working off Nova Scotia now is an off-shore drilling vessel and that would cost in the neighbourhood of $12 million to $14 million. One of these rigs was built at the Halifax dock yards in Halifax. The other rig was brought over from Holland because the second rig would not be available.

The Chairman: Mr. Porter, the first information you gave Senator Isnor about the money you spent in the Halifax area was really...

Senator Smith: There were recent reports that the Halifax company that built it lost a great deal of money on it.

The Chairman: Of course, they are supposed to be able to look after themselves, you know, once they get the job.

Mr. Porter: They are in a risk business, too, I gather.

The Chairman: Mr. Burton, can we put this in perspective? Under the present depletion allowance in Canada, which is 33⅓ per cent of the net production income...

Mr. Burton: No, sir, of taxable income.

The Chairman: Taxable income, whichever way you wish it. In the United States the income base is gross production.

Mr. Burton: Yes, sir.

The Chairman: Now, there is the difference and a benefit there to the operators in the States.

Mr. Burton: Yes, sir.

The Chairman: In that regard and yet Canada has been able to compete in the United States market on its shipments of crude oil notwithstanding that difference. There may be some compensating factors.

Mr. Burton: Yes, sir, there are.

The Chairman: So the whole test is here whether the change proposed is such that it enlarges the difference to an extent that you cannot be competitive.

Mr. Burton: This is exactly what I am saying, sir, yes, sir, quite right.

The Chairman: Could you just explain that a little bit?

Mr. Porter: Senator Hayden, it is the U.S. citizen, I think, as perhaps Mr. Burton pointed out earlier, who has the tax advantage whether he operates in Canada or elsewhere in the world.

The Chairman: Yes, but I was not developing that part of it. I was looking at the export market.

Mr. Burton: Yes.

The Chairman: If you are going to compete in the export market you are going to have to meet prices.

Mr. Burton: That is right.

The Chairman: Well, you are presently under some disadvantage and you have been able to compete and meet prices and make money.

Senator Hays: Do we actually compete with American oil?

The Chairman: Well, in a sense.

Mr. Burton: Yes. You have different meanings in the word "compete". We do ship oil to the States. On every barrel of oil we ship into the United States, the U.S. government puts ten cents a barrel tariff on it whereas oil we

bring into Canada in the eastern half of the country has no tariff.

The Canadian oil, because of the quotas that are put on the United States, is actually sold at a slightly cheaper price in the States than American oil, which is one reason that a lot of the American refineries want to get into Canadian oil.

Senator Hays: What did the discounted dollar do to the ten cents?

Mr. Burton: Well, it reduced the return to the Canadian oil operators because—I do not know what the exchange is today, 4 per cent instead of 8 per cent—so it is the same as everything else we sell out of this country like wheat and so on. There is therefore going to be less money in the purchasers' pockets.

The Chairman: We cannot blame the White Paper for the floating dollar.

Mr. Burton: No sir.

Moving into integration the building industry is divided approximately 70 per cent are closely-held corporations and 30 per cent are widely-held corporations.

Now, we do not of course agree with the comment in the White Paper that basically closely-held and widely-held corporations do not compete and we do not have to give you the usual examples because here you have an entire industry, which is 70 per cent on the one hand and 30 per cent on the other, and they do nothing else except drill so they must be competitive.

Consequently we are not in favour of having the distinctions between closely-held and widely-held because there is complete competition.

Senator Phillips (Rigaud): Now this is an unique opportunity to show the absurdity of the distinction.

Mr. Burton: That is right. I doubt whether there is any other example in Canada like this. There may be but I have not thought of it.

Now, we are opposed to integration for the reasons which have been stated to you before. Speaking as an accountant we have what are known as timing differences. This is where your depreciation comes in. You use depreciation for financial reporting. You use capital cost allowances for income tax reporting.

You have timing differences in mining areas where you have pre-production expenses which you built in initially. You claim them for taxes at one stage and you claim them for financial reporting purposes at another stage.

Because of these various timing differences then obviously you have problems with the creditable tax. In the early years when a company has excess depreciation for drilling expenses, you will pay no taxes and therefore if a dividend is declared you get no creditable tax.

Theoretically down the road there is a cross-over point where you find that you are still reporting these expenses for financial purposes but you no longer have them left for taxes then your tax gap goes away up, but by that time it is too late to recover the creditable that that you lost in the last 30 years.

The Chairman: There is no carry-forward?

Mr. Burton: There is no carry-forward. Then you are bringing in a lot of artificial situations such as the two and a half years. I am quite sure that most of you gentlemen read the report published by the Department of Finance on March 19 which shows you how they propose to handle creditable tax, try to keep it separate and keep a record of it.

They made probably the simplest calculation they could make but I say to you that I have never seen anything in any corporate affairs yet that stays simple. We are living in a dynamic world and you get all kinds of variances in this and when you add that—even that simple statement was hard to understand—when you add all the rest of the things, it is good for my business but I think it will be awful for everybody else.

The Chairman: Mr. Burton, the fact that there is a variance in different applications to different operations, that is enough to make you look very carefully at the system.

Mr. Burton: Yes, sir.

The Chairman: Then No. 2: if the effect of the variance is to create, because of incentives that are given, the effect of reducing the tax and therefore reducing the creditable tax, the combination of these things must make you turn against the integration system.

Mr. Burton: Well, it does, but of course one thing, Senator Hayden, I have not been too sure about, they might have given the oil companies a lot more depletions because they take it all away, when they get into the creditable tax system, so they could really have been quite generous with the corporations.

The Chairman: I can tell you that we had the Hudson's Bay people here before us about a week ago. I think 1969 was the first year in which they were able to take depletion.

Mr. Burton: That is correct, sir. That is the first year they paid taxes.

The Chairman: Yes. And the first year they got depletion because, as I say, depletion is based on taxable income. So, while you may call depletion an incentive, it is up to you to earn it.

Mr. Burton: Yes, sir.

The Chairman: It is different from a subsidy.

Mr. Burton: Oh, absolutely, and you see when people talk about subsidies—I have only been out in Calgary for 25 years—and after the Carter Report came out they were talking about the possibility that subsidies were better than tax incentives.

I spoke to one of my friends who had been out there somewhat prior to my time and had been very active in the oil business. I said to him, it runs in my mind that during the war they were trying to find oil in Canada and they gave some subsidies. I said, "Do you remember anything about it?" and he said "Yes, I do. I remember that." "Well," I said, "what happened to those subsidies?" "Well," he said, "it was very simple. They used the money and drilled the wells in places where nobody else would ever drill."

The Chairman: That was real wildcatting.

Mr. Burton: Yes, and I think that is what can happen so easily with subsidies. Now, sir, you asked me earlier a question and I said I would come back to it. It was about foreign-ownership taking over.

Senator Phillips (Rigaud): Mr. Chairman, may I ask Mr. Burton before we get to that—are you therefore concluding that the present system of depletion allowances won't be retained without any modification?

Mr. Burton: No, sir. I think we should have a gross depletion system.

Senator Phillips (Rigaud): That goes back to the American experience?

Mr. Burton: Yes, sir.

The Chairman: When you say "gross" you do not divide it up between earned and unearned?

Mr. Burton: Well, I am prepared to follow your system and have some of each because I think there could be a place for each.

Senator Phillips (Rigaud): From your experience of the oil companies generally—and there may be some embarrassment on your part and by that I do not mean you individually, but the drillers generally—to express an opinion, but what would be your opinion of what the oil companies generally would prefer as distinguished from what they now have?

Mr. Burton: My opinion is that they would all prefer to have the gross depletion basis.

Senator Burchill: The same as the United States.

Mr. Burton: In effect something along that line.

Senator Phillips (Rigaud): You have not stated that in the brief, have you?

Mr. Burton: No, sir, because it was a drillers' brief, but we did say we did not want to see the petroleum industry having any reduction in their depletion, but it was not up to the drillers to suggest or to speak for the petroleum industry as to what the depletion rate should be.

Senator Phillips (Rigaud): If you were acting for the oil companies, would you specifically repeat what you think would be a proper approach?

Mr. Burton: I would say approximately a 20 per cent gross depletion.

Senator Phillips (Rigaud): In respect of each and every well?

Mr. Burton: Each property interest.

The Chairman: Plus the element of earned depletion, or would you settle for 20 per cent unearned depletion gross?

Mr. Burton: Well, I would settle, to be fair, sir, for 20 per cent unearned depletion gross, and if you want to make a combination, and I have not really thought much about it, so I hate to produce figures, but I suppose it could be a 15 per cent gross and then pick something up on an earned basis in addition. You need a fair set of figures, I think, to come up with something like that.

The Chairman: I think I mentioned earlier that the Gulf people suggested a 20 per cent gross unearned and one for two earned.

Mr. Burton: I did not realize they asked for both. I thought it was either/or.

The Chairman: They asked for both, because conceivably there may be some companies that are not in a position at any given time to earn much in the way of depletion in a particular year, and therefore they could have a gross depletion which is not dependent on that. But when they are in a position to earn it, then at least they are bowing in the direction of the White Paper and what it proposes to that extent. They are recognizing some element of earned depletion.

Mr. Burton: That makes sense.

Senator Phillips (Rigaud): What would the drillers like best from the point of view of getting the most business and still be within a reasonable framework?

Mr. Burton: Well, I think it would be helpful to have the 20 per cent gross for the oil industry. I think that would attract even more people to Canada than we have now.

You asked me, senator, this question about losing control. Again I think the drilling industry is a unique group. In fact at the time of the Leduc discovery in 1947, within the next year or so after that, almost the entire industry—not quite all but almost—was owned by United States corporations or citizens. Between that time and now, as Mr. Porter mentioned, it has become practically all Canadian owned.

There is probably more than one reason for it, but I think one of the reasons that I have seen in my own experience over the years is that in 1948, when our Government introduced the new rates of capital cost allowance and, in effect, doubled the old rates—in other words, if you had a 10 per cent basis previously, and they made it 20 per cent, or 5 and they made it 10—and this was done at that time—and I know some of you gentlemen remember it a lot better than I do—to try to help people to finance, because you could then get a mortgage or whatever kind of security you could arrange, and through this depreciation that you got you were able to pay the capital back more quickly.

Interestingly enough, of course, the United States followed this move. I cannot remember whether it was in 1954 or 1956, but I think it was in 1954, which would be about six years after we did it.

I think this is a typical example of where tax incentive has worked extremely well here in Canada. the United States depreciation rates on drilling rigs is less than that in Canada. Also the United States is somewhat more stringent in regard to the type of repairs that you can put on a rig vis-à-vis repairs for capital.

I have had some experiences of United States drillers who moved rigs to Canada, and they suddenly found they were paying no tax in Canada because of the quick depreciation rates, but there were still paying tax in the United States, and they were somewhat astounded.

Therefore, I am pretty well convinced in my own mind that this had a considerable amount to do with the fact that the Americans did not want to operate rigs up here on what I call a "branch office" basis, and, to some extent, operating within the framework of a Canadian company was not that attractive to them because when they had more problems with getting the profits out of the Canadian company back into the United States, and they could no longer consolidate their operations for United States tax purposes.

Consequently, I say to you that here is an excellent example of what a tax incentive will do, and where Parliament is saying that, "We want Canadians to own Canadian businesses" it has been done by the people in this industry.

The Chairman: Mr. Porter, who is going to speak on capital gains?

Senator Hays: May I ask question first? Mr. Chairman?

The Chairman: Yes, certainly.

Senator Hays: What is the write-off on a drilling rig?

The Chairman: In Canada?

Senator Hays: And what is its life expectancy?

Mr. Burton: In Canada 30 per cent, reducing balance basis. On life expectancy, I think one of these gentlemen should answer that. I think it largely depends on how you look after it.

Mr. Sparrow: That is very true, senator. A highly mobile, small rig—and we have mentioned here a shallow rig of 1,500 feet—that is

not maintained too well, could have a life expectancy, if it were busy, of something in the order of magnitude of three, four or maybe five years.

Mr. Burton: One of these large heavy rigs costing in the neighborhood of $500,000, and well maintained by a very good operator—and remember that we have 43 contractors—could have a life expectancy of around ten years. At that point we have obsolescence, and we have such major repairs that it is no longer possible to obtain the parts.

Senator Phillips (Rigaud): But in the matters relating to capital cost allowance in the White Paper there is nothing that affects the drilling companies as such.

Mr. Burton: No, there is nothing specific, apart from that general hint that they might take a look at the industry later on. I was saying here that we want this to stay the way it is because this has helped Canadians own the business.

The Chairman: Who is going to speak on the capital gains tax, although that area has really been shaken back and forth.

Mr. Porter: I am sure it has, and I will state on behalf of the association that we make the same statement that we made in 1967. We are opposed to a capital gains tax.

Mr. Burton: I think we might add a little bit to that, sir. There is one area here in that while these gentlemen operate essentially in Canada situations do arise where they send rigs to places such as Mexico, Australia, Alaska, and so on. Perhaps they do not send their own rigs, but buy a new rig and have it shipped there, but they do send personnel. We find that we have to move skilled personnel out of Canada for some period of time, and we do not know whether it is to be a year or five years, and we have to say to them: "All right, you have got to sell your house, and pay a tax on the realized gain, and that applies to anything you own." If you are leaving the country this very seriously hampers you.

The Chairman: Perhaps we should follow what Senator Phillips said earlier, and ask you to enumerate the types of things on which the capital gains tax might apply. You mentioned securities and businesses, senator, and what was the other one?

Senator Phillips (Rigaud): Real estate.

The Chairman: Yes, real estate. If it applied in those three categories then the problem would not arise.

Mr. Burton: The problem would be much easier. I am merely speaking of what the White Paper says.

Senator Beaubien: Could you not in some way exempt the people from capital gains tax if they are leaving the country for a year or two? They are remaining Canadians, and they are leaving to do a job.

The Chairman: Of course, we do not have any capital gains tax in this instance now. If we define a capital gain in such terms as Senator Phillips has been discussing, the problem would not apply to the man who was selling his home.

Senator Beaubien: But what if he had stocks?

The Chairman: Well, of course, he might take some precautions to avoid the impact of that. He could do that if he moved early enough. He may have his stocks in such a position of ownership that the problem might not arise. However, we are not dispensing advice here.

Mr. Burton: May I add one other thing?

The Chairman: Yes.

Mr. Burton: As I mentioned before, 70 per cent of the drilling companies are closely-held corporations. You cannot really carve up the ownership of a drilling company. Under the White Paper proposals in respect to capital gains together with estate taxes, if one of these gentlemen had to sell their company because of death or any other reason, there is no way by which they could sell the part of the company owned by a minority shareholder. It could be done legally, of course, but from a practical standpoint nobody is going to buy a minority interest. By the same token you are not going to stay in with it. So the effect of the capital gains tax on some of these people who start off with one drilling rig and gradually build up to 10 or 12, becoming a substantial company over their lifetime, would be prohibitive.

Senator Phillips (Rigaud): In the face of capital gains and estate taxes you simply cannot afford to die.

Mr. Burton: You are absolutely right, sir.

Senator Phillips (Rigaud): You have provided for longevity, which is the only credit you obtain from the White Paper.

Mr. Burton: You have found the solution, sir.

The Chairman: He has found the solution, but not the way to do it.

Mr. Porter: The White Paper does not comment on that.

Senator Phillips (Rigaud): We are getting a real bonus from the Minister of Finance.

The Chairman: Are there other features in connection with your operation which you would like to discuss?

Mr. Porter: There are. I will put this under the general heading of uncertainty. Mr. Breton very kindly distributed some material. I will ask Mr. Sparrow to comment on the figures contained in the material headed Western Canadian Drilling Activity.

I would like to speak on this general topic of uncertainty and how it has affected our industry, as demonstrated by some of those figures.

Yesterday afternoon you heard Mr. Van Renssalear of Bow Valley Industries refer to the fact that his company had been unsuccessful in attracting U.S. dollars to the country for drilling ventures since some time late last year. Investment uncertainty developed by the White Paper has had a debilitating effect on our industry.

There are other uncertainties created by the action or inaction of Government. I refer to lack of successful development of oil and gas markets in the United States.

The third point relates to certain speeches delivered by senior members of the Government with reference to foreign investment. We are given to understand that there will be regulations governing the type of foreign investment that may be available.

The combination of these factors has had a very serious effect on Canadian industry and Canadian employees who, in turn, buy a substantial volume of Canadian goods. It just does not make sense to us to have a resource that is in demand and in complete contradiction to this our Government acting in a manner which makes our operation completely unsuccessful.

Senator Hays: How many wells were spudded in this year compared with last year?

Mr. Porter: In the first five months of this year?

Senator Hays: Yes, compared with the first five months of last year?

Mr. Porter: We interpret that figure in another way, Senator Hays. I will answer your question briefly this way: the number of wells drilled in the first five months is down in about the order of 14 per cent for the first five months of 1970 as compared with the same period of 1969.

The footage is only down about 8 per cent, because the holes being drilled are deeper wells in the foothills. However, those are not the true yardsticks of our economic activity. The real figures are our income days, how many days we work.

Senator Hays: I was interested in the comparison between the number of wells drilled in the two periods.

Mr. Porter: The number is down by about 15 per cent. In real volume we could interpret that to mean something in the order of down 150 wells.

Senator Hays: That is from the first five months of last year?

Mr. Porter: Yes sir.

Senator Hays: Or a year ago.

Mr. Porter: Yes, sir.

Senator Carter: Is that in anticipation of the White Paper?

Mr. Porter: I cannot say all of it is, to be truthful. I would say the White Paper, the lack of development of markets, the apparent restrictions that are forthcoming and statements by certain members of the Cabinet on foreign investments have all had an adverse effect on our industry.

Senator Carter: Do you know what the comparable figure is in the United States for the first five months of 1969 and 1970?

Mr. Porter: I do not know frankly. Bob, do you have any figures on that?

Mr. Sparrow: The only thing is, I know they did suffer some depression during the winter months as far as the number of rigs running related to the number of holes drilled. They did hit a low spot, but it has subsequently recovered to what it was this time last year, particularly when that is relat-

ed to our top figure here, which shows 88 rigs running this year versus 140 running a year ago.

The Chairman: Mr. Sparrow, you were going to refer to the western Canada drilling activity.

Mr. Sparrow: Yes, sir, if I may. If you refer to the western Canada drilling activity sheet, I think the figures are more or less self-explanatory. We point out how we are doing this year compared with a year ago, with the net change in the number of rigs operated in percentage off 37 per cent this year over this time last year. As Mr. Porter said, how we relate our actual revenue days for the recording system is that the figures are compiled by a computer by our association from all our contractors. We actually show the rig operating days, and you can see that for the twelve months ended April 30, 1970, compared with similar figures last year, we had a 14½ per cent reduction. In the first five months of this year versus the same period last year we are off 21½ per cent. However, we are going off very fast with June, and our forecast for the balance of the year based on what we can see from industry surveys for exploration and development drilling plants would indicate that if things are not settled soon we will be looking at something of the order of a 35 per cent drop over last year. Last year was a more or less typical year. Our business by nature tends to be cyclical, both from year and season standpoint, although in the last possibly four or five years it has levelled off at a reasonable level of activity, up until the past year.

The Chairman: Would the explanation be that the search for oil is moving further north, or that there is a very substantial factor of delay or deferment by reason of the White Paper proposals?

Mr. Sparrow: We seem to see delay and deferment rather than the other. Tight money we certainly recognize has had an effect too. However, very many of the people we talk to—particularly from the south—have indicated that they are delaying and deferring, and possibly cancelling plans they might otherwise have had for drilling this year.

The Chairman: It is not necessary, would you say, to push further north; there are still areas for exploration for oil closer to existing oil areas?

Mr. Sparrow: That is correct, sir.

The Chairman: And in the ordinary way you might find some expansion in that direction?

Mr. Sparrow: Yes. I could refer you to a map which we have in our submission, following page VIII-12, which shows the distribution of wells drilled in 1968 and 1969. Further to that we have passed out a large map which shows the distribution of drilling rigs throughout the Prairie Provinces, the Northwest Territories and the Yukon.

The Chairman: Does that cover all of the points, Mr. Porter?

Senator Hays: Do you have any figures on the total number of wells which have been drilled in western Canada, say up until the end of 1969. There used to be a projection as to how many wells would be drilled in the future. Are those figures available?

Mr. Sparrow: Yes, those figures are available.

Senator Hays: You do not have them?

Mr. Porter: The historical figures are available, but we do not get any forecasts from the oil companies. It is made available to the association or the individual contractors who say that they are going to drill 25 wells the next year with five in this location and 10 in this one. We can speculate. It is the size of the budget as to where they are going to get the highest rate of return and what success they will have.

Senator Hays: And how much money they have.

Mr. Porter: And how much money they have.

Mr. Burton: We are opposed to the treatment they are suggesting of good will because we think the retroactive feature is a penalty and I think it is absolutely wrong.

The Chairman: Thank you, Mr. Porter.

The Chairman: Gentlemen, we move on to one more brief. The people who are going to submit this brief have been very patient and I think we should be patient in hearing them. We have now the National Association of Tobacco and Confectionery Distributors. Mr. E. J. Hartnett is the Chairman of the association and will make the opening statements and present his panel.

Mr. E. J. Hartnett, Chairman, National Association of Tobacco and Confectionery Distributors: Thank you, Mr. Chairman and honourable senators. My name is Hartnett. I am the Chairman of the Legislation Committee of the National Association of Wholesale Tobacco Distributors. I would like to introduce Mr. Paul Kaiser, the Chartered Accountant, who has done a considerable amount of research and study in the tobacco distributing industry and Mr. John Cunningham, the Assistant Executive Secretary of our association. Our association emphasizes small and large wholesale houses across Canada from Victoria to Halifax.

Senator Phillips (Rigaud): There is no distribution of confections in order to get an idea of the nature of your business?

The Chairman: There are no samples today.

Senator Beaubien: We are being shortchanged, Mr. Chairman.

Mr. Hartnett: However, we do represent the distributors and the majority of the members of our association are small business people. Having listened to the brief we had before today I realize that we do not have all the problems. We are indeed happy to be invited. In presenting our brief some months ago, we endeavoured to make it short and to the point.

Mr. Kaiser has reviewed it and has a synopsis of the brief and will carry on from that point. We will be glad to answer any questions that may come up.

Our brief represents two proposals. I may say that I am grass roots distributor—I emphasize "grass" and "roots"—having been in the business for a number of years. I have been associated with the jobbers and distributors across Canada. We represent about a billion dollars in sales and many millions in equipment and accounts receivable and inventory. We have had the good fortune to talk to the minister on occasions about our problems, and we appreciate that.

I am going to ask Mr. Kaiser to carry on.

Senator Burchill: Is your association confined to Montreal?

Mr. Hartnett: No, it is across the country, sir.

Senator Burchill: Outside the Province of Quebec?

Mr. Hartnett: In all the nine provinces from Victoria to Halifax.

Senator Burchill: Good.

Senator Phillips (Rigaud): Mr. Chairman, before Mr. Kaiser starts, I find the brief extremely interesting because it covers two points to which we have been giving close attention. One is the treatment of small businesses. We will be getting around quickly to page 5 there, an alternative is given to the treatment of the lower bracket companies and incidentally there is defined in this "companies with a profit of less than $100,000". I am simply drawing the chairman's attention to that.

I beg to assure the gentlemen here that this Senate committee is more concerned about small businesses than we have been about big businesses. I am sure the chairman will want me to say this, that we have been very anxious and sensitive to the problems of small businesses.

The second point to which I should like to draw the attention of honourable colleagues is a very interesting suggestion, that the whole problem of surpluses can be dealt with at the end of every five years, by distribution, redeemed distribution, except that there has been a partial suggestion that this is be done by the application of section 105, upon payment of 15 per cent, rather than in the manner that Mr. Kaiser is coming to.

So I would like to express the view that we are dealing with two very interesting and constructive suggestions.

The Chairman: Before Mr. Kaiser gets going, we have been examining practically everybody who has come before us to give some expression of viewpoint on small business, because from the very beginning we felt that small businesses should be taken care of separately and should not lose the status which it presently has.

It finally resolved itself into, how do you define a small business. We were told that, while net profit would appear to be the best way. Then it arrived, how much net profit? We had a range that went anywhere from $50,000 to $100,000 of net profit, the idea being that a small business would be such a company and it would be entitled to 21 per cent on the first $35,000. The reason for this of course is that a small business is not attractive to the capital investment market. Therefore you have to find your capital out of retained earnings.

Representatives of the Toronto Stock Exchange appeared before us and we discovered in talking to them that a company which has net profits of at least $100,000 could, if it met other requirements, be listed on the Toronto Stock Exchange. So the reaction that seemed to come from that, as far as we were concerned, was that we could not very well set the figure of net profit at $100,000 on the basis that the market is not available, because if you presented the right kind of material, presumably you could list, and if you could list, presumably somebody might take on the distribution.

Now, supposing we wanted to define small business by reference to net profit at $75,000 or at $80,000 or some figure under $100,000, what would be a reasonable definition of a small business as far as you are concerned?

Senator Isnor: You are speaking now of net profit.

The Chairman: Net profit before taxes, yes.

Mr. Hartnett: I think perhaps Mr. Kaiser has an answer to that in his submission.

The Chairman: All right.

Mr. P. Kaiser, Consultant, National Association of Tobacco and Confectionery Distributors: I hope you have all received two photostated sheets that have been distributed. They were prepared in anticipation of this question as to how a small business could be defined. I had directed my opening remarks to answering just that question, and I would like to take a brief moment to review the opening statement which, preliminary to reviewing the brief, covers or deals with this question of what is a small business.

To date, a small business has been one whose earnings have been less than $35,000. Over the years, the Government has recognized the need for extending this tax umbrella from $10,000 in 1949 to $20,000 in 1953 to $25,000 in 1958 and finally to $35,000 in 1962. Smallness, therefore, was measured only in relationship to earnings and without reference to net worth, to the capital requirements for growth, to the risk factor, to the number of shareholders, to the financial strength of the business to raise funds needed for its growth.

The Chairman: Nor to the volume of sales?

Mr. Kaiser: Nor to the volume of sales. It was just restricted that on the first 35,000 a company was to get a preferential tax rate, and this was even extended to the companies who were making many millions of dollars. This, perhaps, is the inequity of the law. A company—and I do not want to single out any one specific company—making millions of dollars of profits would still benefit from this lower tax rate on the first $35,000. Now our brief, as you will see shortly, suggests a formula for reducing this $35,000 umbrella at the rate of $500 for every $2,000 that earnings exceed $100,000 as a point at which to start considering the matter. I felt that perhaps other people would see it differently; the Minister of Finance specifically might be inclined to cut that figure. But these were all considerations in defining a small business.

The Chairman: Just a minute, now. If you take 100,000 and you reduce that by $500...

Mr. Kaiser: $500 for each $1,000. When a business earns $170,000, which is twice the 35,000 over the $100,000, it would lose entirely insofar as that $35,000 unbrella was concerned.

The Chairman: Your ideas then reach a higher figure than ours, and would bring you to a higher position than was envisaged by the Minister of Finance when he introduced this concept.

Mr. Kaiser: Yes.

The Chairman: His idea was that the thing would iron out to a regular corporate rate at $105,000.

Mr. Kaiser: Yes.

Senator Carter: Are you stating then that when a business reaches that net income, $175,000, that they would then have access to financing in the markets?

Mr. Kaiser: No, this was not taken with any particular reference to market financing, and if I may add, the $105,000 market that the Minister envisaged was for the purpose of accelerating the elimination of the $35,000 umbrella over the five years. My understanding of the White Paper was that the $35,000 would be eliminated at the rate of $7,000 a year. The $105,000 is only with reference to the phasing out. Once the five years have elapsed all businesses will be taxed at 50 per cent.

The Chairman: That is right, but what we are interested in is getting your view, not on the phasing out but on the continuance of this rate for small business of 21 per cent on

$35,000. We are not asking you to give us any termination date for it. Just tell us, with this concept that small business serves such a purpose and has problems of its own as to capital, that it should enjoy a special rate to enable it to retain earnings as its capital. We are not looking at any termination date. We just want to know what kind of definition of "small business' you would give us. I have told you what we are thinking.

Mr. Kaiser: The definition contained in our brief was that up to $100,000 net earnings per year the full $35,000 tax umbrella be left intact; that the business enjoy the lower rate of tax on that first $35,000.

The Chairman: And as to the balance, pay the regular corporate rate, or would there be a phasing?

Mr. Kaiser: No, earnings in excess of $35,000 would be taxed at the present corporation rate. Once earnings exceeded $100,000 that $35,000 umbrella or tax shelter would be reduced at the rate of $500 for each $1,000 the company earned over $100,000, so that once the company's earnings hit $170,000 per annum the $35,000 tax shelter would have been completely eliminated.

Senator Phillips (Rigaud): You are introducing a medium-small company between $100,000 and $175,000?

Mr. Kaiser: Yes.

Senator Beaubien: So by your formula a company earning $100,000 would pay $7,350 on the $35,000, and it would pay 50 per cent on the other $75,000, is that what you mean?

Mr. Kaiser: Yes. And I might just add, by way of rates, if you integrate the Ontario rate or the Quebec rate with the federal rate and consider the 3 per cent temporary surtax, the effective rate on the first $35,000 is now 23½ per cent.

Senator Phillips (Rigaud): I think we have that. I think your formula is clear. I would like to get your further thinking on the question of distribution of dividends at the end of every five years.

Mr. Kaiser: Right. Might I, with your kind permission, just finish my introductory statement on small companies, and then go back?

Senator Phillips (Rigaud): Yes. I thought you were through; I am sorry.

Mr. Kaiser: No. I am sorry.

I say that smallness should not be defined in absolute terms. A business is not small while earning $35,000 and then big, or at least middle-sized, because it just exceeded the $35,000 mark. There are degrees of smallness, degrees to which a business should be assisted, and, as we shall see shortly, we have suggested a formula for taxation in our brief which would give a business a tax deferment in accordance with the degrees of its smallness. It is difficult to integrate such factors as "risk" into a specific tax formula. It is sufficient to recognize varying degrees of risk in smaller enterprises and to realize that some concessions are in order.

It is easier to measure the proportion of profits that have not yet been liquidified, in that they are still outstanding in the form of accounts receivable, or have been re-invested in the larger inventories required by the growing business, or have been re-invested in equipment. Businesses whose shares do not trade on a stock exchange and who have only limited resources are less able to raise the capital for growth than their larger public counterparts. They are also far less able to survive hard times.

The Chairman: Mr. Kaiser, we concede all that.

Mr. Kaiser: Then, on the basic premise that all large businesses once started small, we will go on to the formula.

Senator Phillips (Rigaud): Let me get to that formula. I think honourable senators understand it. We have read your brief, and it is extremely interesting. Is not the effect of that formula one of penalizing the success of small business. If a small business succeeds in increasing its profit from $100,000 to $170,000 you are deliberately taking away the benefit it had as a small business with respect to profits after the first $35,000.

Mr. Kaiser: Well, I think what we had in mind here is that once a business reaches the $170,000 plateau, it is able to pay its way a little better, and the concessions that it needs from the Canadian taxpayer are less pronounced.

Senator Phillips (Rigaud): But you seem to be placing a premium upon ineptitude by saying that if you do not go above $100,000 you will get the benefit, whereas if you improve your profits in excess of $100,000...

The Chairman: You have got to be either a small business or not a small business. If you are not a small business then the regular corporate rate applies. Therefore, what we have to do is to define a small business. The concept that we had for some time is a net profit of $100,000. If you have profits up to that amount then you could be classified as a small business, and you have the 25 per cent tax rate on the first $35,000, but other earnings would be subject to the full corporate rate. But, you realize, do you not, that getting the 25 per cent tax rate on the first $35,000 means that you have extra retained earnings of over $10,000 a year, which is a valuable contribution to small business.

Mr. Kaiser: Yes.

The Chairman: But at some stage their earnings will move them out of that. What you are suggesting is that some element of the 25 per cent on the first $35,000 will finally be exhausted when the net profits reach $170,000. I understand it. I am not expressing a view one way or the other, but in the light of other evidence we have had here it would appear that you might have some difficulty in supporting the statement that a business that has net profits of $175,000 a year should be classified as a small business.

Mr. Kaiser: Well, Mr. Chairman, once it reaches that mark of $170,000 it may be enjoying maybe $1,000 of taxable income at the lower rate. Let us say it is $168,000; it will be only enjoying $1,000 at the lower rate...

The Chairman: But what I am asking you is: If there is an incentive given to small business by means of a lower corporate rate, then when small business gets beyond the stage of a definition that we might settle on, why should it any longer get the incentive?

Mr. Kaiser: It should not.

The Chairman: No. When we are told that it is possible to finance and get capital for businesses that are earning in excess of $100,000, then it would appear that the area is somewhere up to $100,000 of net profit. What you have said in your memorandum is that to date a small business is one whose earnings have been less than $35,000 over the years. I do not quite understand that. Do you mean that the people who are members of your association have earnings of only up to $35,000 a year?

Mr. Kaiser: No. If I might just explain this, what I am citing here is the law as it presently exists. Up to date a lower rate has been conceded on the first $35,000 of annual earnings of all businesses...

The Chairman: Of every company.

Mr. Kaiser: Yes, of every company.

The Chairman: And now the White Paper takes it away from all the companies.

Mr. Kaiser: Yes.

Senator Beaubien: In five years.

The Chairman: Yes. If the small business is entitled to special consideration, where should it stop?

Mr. J. L. Cunningham, Assistant Director, National Association of Tobacco and Confectionery Distributors: It is a fact that a small business does not become a large business overnight. When it is making $36,000 it is not a large business but still relatively small.

The brief suggests that as it becomes large, which is a transitional period, the tax umbrella be reduced over a certain period of time, giving it a five year period in which to have fallen into the definition of a truly large business.

The Chairman: But where is the place that the phasing out should be reflected? It would appear to be a hardship to give you 21 per cent on $35,000 and at $35,001 have you pay the full corporate rate.

Some calculation would have to be made as to the difference between the 21 per cent rate and the corporate rate and how far along the line you go before the area in which you operate falls within the definition of a big business.

Therefore, if $100,000 is the definition of a small business, the area should be between $35,000 and $100,000.

Senator Beaubien: How would it be if the formula at the bottom of page 5 were started at $500 for each $1,000 that the company earned over $65,000.

The Chairman: Over $35,000.

Senator Beaubien: That would phase out very quickly.

The Chairman: The formula could phase it out at $100,000.

Mr. Kaiser: It would have to start at $30,000, because $1,000 is double the $ 500.

In other words, you lose $500 of tax umbrella for every $1,000 of earnings. Therefore, to take a business by your definition earning $30,000 it would receive the full umbrella. By the time it reached $100,000, which is $70,000 more, the mathematics would have to be recomputed.

Senator Phillips (Rigaud): But you are retaining the chairman's suggestion of dealing with the subject matter of $35,000 to $100,000?

Senator Prowse: Why sould the company not go into a partnership position and be subject only to taxation on whatever level they earn?

The Chairman: Whether or not that would be an advantage would depend on their marginal rate.

Senator Phillips (Rigaud): Everyone has the right to form a partnership.

The Chairman: They do not need permission. However, the people forming the partnership may have a marginal rate of more than 21 per cent. Therefore I have suggested that maybe they should be given the option, even though they are a partnership, to pay the 21 per cent, which is also the corporate rate. That would be even-handed justice.

Senator Beaubien: Do you mean to say that lawyers can do that?

The Chairman: Do you mean even-handed justice?

Senator Beaubien: Yes.

The Chairman: Judges do.

Senator Phillips (Rigaud): It is a refinement. I would like to go to the second point.

The Chairman: I do not want to cut you off, but we think we have a pretty full understanding of this problem. We understand what you are proposing, but we feel we have to compress it within limits of whatever the definition is that we settle.

Mr. Kaiser: May I just add this one thought. Recognizing what the gentlemen from the Toronto Stock Exchange told you, I would venture to say that of the companies listed on that exchange only a very small percentage have earnings of less than $250,000 per year. They may be listed with $100,000 but I venture to guess there are not too many.

Senator Beaubien: No, there are few.

Senator Hays: Of course, you are speaking of customers as well. They were dealing with clientele, customers as well as the companies they represented.

Senator Phillips (Rigaud): The second point in the brief is dealt with on page 6, at the top, where you say:-

> The second phase would be to require the payment of a dividend within 5 years after the end of the corporation's tax year.

I am interested in that aspect, not particularly in relationship to the small company, but the whole conception, that, as we discussed, through the abandonment of integration and the 2½ year business, deemed-to-be capital gains and so on, one way to get that revenue to the Crown and one way to avoid abuses of the accumulation of excess capital is the capitalization of surplus in holding companies at the end of every five years.

The Chairman: I would think that the provisions in the income tax law now, under which they can take out the surplus at 15 per cent, or some figure of that kind, would be attractive to you, would it not?

Mr. Kaiser: Yes.

The Chairman: And more attractive than what you are proposing.

Senator Phillips (Rigaud): And make it mandatory for all corporations, other than operating companies.

Mr. Kaiser: May I comment on that? I believe the 15 per cent is only a transitional provision, again to get existing surplus out of companies.

The Chairman: Where do you think your retained earnings would appear in the balance sheet? Would they not appear as surplus?

Mr. Kaiser: Yes, they would, but under the proposals of the White Paper they would have to be paid out within 2½ years.

The Chairman: We did not state the assumptions we are making. We are making assumptions that there is not a $2\frac{1}{2}$-year limitation, that there is not integration, that there is not a five-year revaluation, that there is not any difference between closely held and widely held companies. If you are going to deal with small business separately, you are lifting it out of that context; you are putting it in a category of its own, so that it is not subjec to any of these other provisions. That is the basis on which we are discussing it.

Mr. Kaiser: I think I understand.

The Chairman: Therefore, if you could take surplus out at 15 per cent, it would be a good deal.

Mr. Kaiser: Yes.

Senator Phillips (Rigaud): What we are saying through the chairman is this. There is something to the point that if small business is given special treatment and the benefit of 21 per cent on $35,000 is taken away from all other corporations, maybe there ought to be an offsetting factor because of the privilege given at the end of five years and assuming the 15 per cent rate available under section 105 that you pay a 15 per cent rate and capitalize your surplus.

The Chairman: We do not have to take it out. You pay the 15 per cent and capitalize. Whenever you take it out you can put it in preferred stock and redeem it any time that you want the money and not pay any more tax.

Mr. Kaiser: There is a provision in section 105 at the present time. This would be a liberalization of that provision.

Senator Phillips (Rigaud): This would eliminate any criticism that we are too indulgent to small businesses in respect to profits over $100,000. Every five years you capitalize on your undistributed earned income. The corporation pays 15 per cent and you are sitting pretty with a capital asset of 85 per cent of that surplus.

The Chairman: That is the price they pay for the incentive. That is, you would have to go through the process of paying 15 per cent tax on your surplus about every five years. Do you not think that would be a good plan?

Mr. Kaiser: It is not something envisioned in our brief, but something that sounds like a very good plan.

The Chairman: On the assumption you are lifted out of all the provisions of the integration.

Mr. Kaiser: And it would be something which would be mandatory and you would have to pay the 15 per cent tax.

The Chairman: You would have to pay the 15 per cent tax every five years, but not the money. You would capitalize it in the company in preferred stock and then you could redeem that any time you wanted the money.

Mr. Kaiser: Fine, or loan it out and put it back.

The Chairman: That is right.

Senator Phillips (Rigaud): You have five years before the mandatory capitalization is there, so you are not taken off guard with your creditors and bankers.

The Chairman: That sounds like a good proposition. Is there anything else? I think we have covered the two points in your brief.

Mr. Kaiser: There is one important point which I would like to mention and that is in respect to conventions. The NATCD holds a number of conventions in which the members have an opportunity to discuss their mutual problems. They very often bring in speakers, including university professors, in order to educate the members. We believe that Mr. Benson or the general terms of reference in the White Paper would eliminate the deductibility of these conventions.

Mr. Chairman: Mr. Kaiser, what I would say to you is that the Income Tax Act at the present time in section 12 permits the deductions as an expense of money reasonably laid out for the purpose of earning income. We think all the administrative power to check on the validity of expense is there and they do not need anything more. I think that is a fair statement.

Mr. Cunningham: We were going to make a suggestion, because there are abuses in this

business of tax deductibility. I realize the point.

The Chairman: If there are abuses the machinery for checking them is right in the act now.

Senator Haig: And it is being used.

The Chairman: Is there anything else you would like to add?

Thank you very much. You have given us some help. We feel more confident about our own concept of small business and how it should be dealt with.

The committee adjourned.

APPENDIX "A"

THE TRUST COMPANIES ASSOCIATION OF CANADA

A Submission on the Proposals
contained in the White Paper on Taxation

to

the Standing Committee on Banking, Trade
and Commerce of the Senate

May 1970

SUMMARY OF THE MAIN POINTS OF A SUBMISSION BY THE TRUST COMPANIES ASSOCIATION OF CANADA ON THE PROPOSALS OF THE WHITE PAPER ON TAXATION

Owing to restrictions of space this summary touches only upon the central opinions and recommendations of the Association as reflected in its submission. Some recommendations and many details are not covered.

Relevant Paragraph(s) of the Submission	PART I OF THE SUBMISSION - GENERAL COMMENTS:
1.01	Association membership consists of 27 Trust Companies and 7 Mortgage Loan Companies.
1.03	Changes in Taxation should be co-ordinated with the provinces before enactment.
1.06	Proposals for substantially increased tax revenues might well have been accompanied by some indication of the use to which they would be put.
1.07	The effect of current tax philosophy in reducing savings and dissipating pools of capital is disturbing.
1.08	Canada needs vitality and enterprise. She will not get it with a further diversion of capital into government revenue.
1.09	A Capital Gains Tax is economically undesirable at the present stage of Canada's development.
1.10	Proposals for integration of personal and corporate income are controversial, complex and of uncertain effect: they should be re-examined.
1.11	The effect of some proposals could well be to impede the inflow of foreign capital.
1.12	The White Paper would impose a penalty on the raising of debt, as opposed to equity, capital.
1.13	The proposals for elimination or reduction of tax burdens for some groups are commendable, but the resulting tax increases for "middle income" groups are too heavy.

Relevant Paragraph(s) of the Submission	PART II OF THE SUBMISSION - TECHNICAL PAPERS:
[illegible] - [illegible]	The tax relief proposed by the White Paper should be achieved by rate structure changes: not by increase of personal exemptions. Increases in tax rates can and should be kept to a minimum.
[illegible]	The $500. additional personal exemption should be made available at age 65.
[illegible]	The "block averaging" system proposed by the Royal Commission on Taxation should replace the averaging system proposed by the White Paper.
4.01 - 4.17	Obligations of pension plan trustees should not be extended in scope: Contribution limits of retirement savings plans should be raised: Percentage limitations on foreign holdings of pension and retirement savings funds should be higher than proposed - certainly no less than 20%: Lump sum payments at death or termination should not be taxable at full rates.
5.01 - 5.23	If a Capital Gains Tax is inevitable, gains, with the possible exception of those realized within six months, should not be taxed as income but at one-half marginal rates, with a maximum of 25%: The proposed 5-year deemed realization should be abandoned - death should be treated as a disposal - and estate tax should be phased out: There should be no deemed realization upon departure from Canada.
[illegible]	The proposed distinction between closely and widely-held corporations should be abandoned, and other more simple methods of reducing or eliminating double taxation should be found.
[illegible]	Abolition of the two rate structure of tax on corporations should be conditional upon provision of alternative means of financial assistance for small business.
8.02	The proposed disallowance of certain entertainment and related expenses should not be given effect.

Relevant Paragraph(s) of the Submission	
9.02	Section 62(1)(d) of the Income Tax Act should be amended so as to cover bona fide trade associations.
10.01 - 10.47	There are many different kinds of Trusts, and they are established for many purposes. By no means all have tax implications or, of themselves, should have tax consequences. They cannot, and should not, be treated alike for tax purposes.
10A.25	The proposals for the treatment of Investment Fund Trusts, in particular, are based on misconceptions. Such Trusts are not analogous to widely-held corporations. Their present tax treatment should be continued.
11.11	The proposed treatment of non-resident investors, both individual and corporate, is discriminatory and probably self-destructive. Non-resident investors bring a good deal of economic benefit to Canada: tax treatment proposed for them should be moderated.
12.02 - 12.06	The proposed deemed realization of capital gains and possibly higher withholding tax, for those leaving Canada for residence abroad, constitute a serious restriction of traditional freedom of mobility. The deemed realization should be abandoned, and no withholding tax should be levied on payments from registered pension plans.

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PART I - GENERAL COMMENTS

1.01 This brief is submitted by the Trust Companies Association of Canada which consists of the twenty-seven trust companies and seven mortgage loan companies listed at Appendix I. Of the assets of some twenty-nine billion dollars entrusted to the trust and mortgage loan industries, the great bulk is administered by our member companies. The two kinds of companies are Canada's most important mortgage lenders.

1.02 We appreciate the opportunity to contribute to the public debate on the White Paper. This open approach to changes in our taxation system has provided a valuable opportunity for public debate and for the presentation of views by interested parties to the Parliamentary Committees concerned.

1.03 We regret that the same opportunity for public debate was not provided when important changes were made recently in estate and gift tax legislation. Moreover, that legislation was not co-ordinated with those provinces which maintain their own succession duties. It has become immensely difficult to devise estate plans in Quebec, Ontario and British Columbia in view of the conflicting maze of federal and provincial legislation on death taxation. Co-ordination with the provinces should have preceded the enactment of new estate and gift tax provisions. We strongly urge that future changes in taxation be co-ordinated with the provinces before enactment.

1.04 Like most Canadians, we are in accord with the long stated need for reform of our taxation system. It is our opinion, however, that true reform can best be effected by continuing evolution of the existing legislation. We do not accept the apparent philosophy of the

Carter Commission and of the White Paper proposals that the existing legislation be abandoned in favour of an entirely new system. Our concern has grown as we have studied the White Paper and as the debate on it has developed. It has become apparent that the White Paper does not contain proposals aimed primarily at realistic tax reform but at achieving a new social structure in Canada by means of revolutionary changes in our taxation system. A lack of realism is apparent throughout. It is indicated by the unworkability of certain general proposals, by the apparent effects on specific sectors of the economy and by a disregard for international implications. We think it unfortunate that tax reform might take this direction in Canada. We believe that the positive recommendations in our brief are in the nature of true reform of the existing taxation system and that they are realistic. The White Paper proposals appear to be directed at closing "loopholes" and solving problems, most of which have already been dealt with by legislation or use of powers already available to the Minister of National Revenue. In our opinion the new tax structure proposed would be likely to encourage evasion as a result of the harshness of its impact and, by the introduction of novel techniques as yet untried, provide new opportunities for avoidance.

1.05 There appears to be in Canada a frightening tendency for the total demands of governments on the Gross National Product to increase in percentage and to grow faster than the growth of our national productivity. This process, among other side effects, constantly erodes the private ability to save and discourages the saving process by the difficulties which it imposes. The implications

of this continuing trend cause us great uneasiness for the future of our country.

1.06 The White Paper makes clear that its proposals would lead to an estimated increase in the revenue, by the fifth year, of some $630 million. This estimate has been questioned and may well err considerably on the conservative side. Even making due allowance for the difficulty of projecting accurately the effect of a variety of tax changes on the revenue, it is difficult to understand a proposal that would increase the government's revenues to this extent without providing some indication of the purposes to which the expanded revenue would be put. It is true that rates of tax could be lowered if revenues prove to be larger than needs, but past experience does not make us optimistic on this score. It would be more appropriate for the government to moderate its proposals for tax increases and to justify further demands when, and if, proposed programmes appear to merit them.

1.07 We are deeply troubled by the effect of current tax philosophy in reducing savings and dissipating pools of capital. The White Paper contemplates, with an equanimity not shared by us, a reduction of about $525 million in personal and corporate savings by the fifth year. This, viewed in the light of the recently enacted changes in estate and gift tax legislation and recent increases in the taxation of life insurance, surely would place a completely irrational burden on the formation and conservation of capital.

1.08 We need capital in this country in vast quantities: for housing: for investment in new plant and equipment: for the replace-

ment of old plants. We need it to help improve our already lagging productivity. We need increasing investment to provide jobs for the army of young men and women now entering the labour force. We simply cannot accept the view that in the 1970's, in a country still largely undeveloped, a tax system which reduces and discourages the saving process and reduces pools of private capital is a good one. We need vitality and enterprise in Canada and we are not going to get it by allowing a further diversion of capital in the hands of the private sector, into revenue in the hands of government.

1.09 We regret that so many appear to view the imposition of a capital gains tax in Canada as inevitable. It is economically undesirable on the grounds that Canada, as a net importer of capital, is in a very different stage of development compared to capital exporting countries with capital gains taxes. A capital gains tax in Canada must be carefully conceived to provide the minimum of hostility and discouragement to the formation and free flow of capital. Its potential for damage to our economy, if ill-conceived, is immense. Our concern is that if the White Paper's proposals regarding capital gains tax are implemented, this potential for capital destruction will surely be realized. The proposed tax is restrictive to capital flows, hostile to certain types of capital, somewhat arbitrary in design and, consequently, inequitable. Its application is seriously impractical in a number of areas; the proposed rates are too high and it incorporates a capital levy. In the second part of the brief, under the heading Capital Gains Tax, we deal with the proposals and offer alternatives for consideration.

1.10 The proposals to integrate personal and corporate income are controversial and of uncertain effect. In view of the rejection of integration by most other nations with comparable tax systems and in view of some obvious inherent disadvantages, we think it desirable to re-examine these proposals with the objective of achieving simplicity; eliminating artificial distinctions between corporations and the discriminations which they now contain. We consider that the integration proposals complicate the tax system unduly. This matter is further dealt with in the technical paper on the subject.

1.11 There appear to be a number of factors in the White Paper which could well impede the inflow of foreign capital. International capital flows operate on a two-way basis. If an attempt to encourage investment in Canada by Canadians, however laudable it may be in itself, tends in practice to reduce the flow of Canadian capital abroad, it may well have the same effect on the flow of capital into Canada.

1.12 There will continue to be a strong demand by the Federal, Provincial and Municipal Governments, as well as by industry, for debt capital. The White Paper imposes a penalty on the raising of debt capital as compared to equity capital. The consequences of such a situation could well be serious and could lead governments, searching for markets for their securities, to attempt to introduce very undesirable restrictions upon investment.

1.13 Because we think that the burden of taxation in Canada is already too great, we approve of the proposals in the White Paper to remove some taxpayers from the federal income tax rolls, to modestly

reduce the rates of taxation for some others and to bring the top marginal tax rate to a more reasonable level. On the other hand, the proposed increases in the taxation burden on the middle income groups are undesirable and should be kept to an absolute minimum.

1.14 Our industry is concerned with the general impact of the proposals on the Canadian economy and on Canadian society. We are also concerned with specific proposals that particularly affect our industry and its clients. These we deal with in the subsequent technical part of the brief.

PART II - TECHNICAL PAPERS

EXEMPTIONS AND RATE CHANGES

2.01 The White Paper proposes to relieve completely some 750,000 Canadians from payment of federal income tax and we share what we believe to be the general approval of Canadians of such an objective. Evidence before the Banking, Trade and Commerce Committee of the Senate indicates the cost of this to the revenue to be about $35 million annually.

2.02 The White Paper also proposed to reduce the federal income tax burden on single persons receiving more than $1,546 per year, but less than $3,400 and on married persons receiving more than $2,990 but less than about $9,100. This proposal too can only receive general approval.

2.03 The proposed elimination from the federal income tax rolls of one substantial group and the proposed tax reduction for a larger group would be accomplished mainly by an increase in personal exemptions. Further, it is proposed over a five year period to reduce the top marginal rates from the present 82.40% (in provinces that levy 28% of the federal tax) to 51.20% (in the same provinces). The White Paper foresees the reduction of revenue from this proposal to be some $40 million in the fifth year. These two important objectives, exemption from tax for 750,000 people and reduction of the top rate to 51.20%, can thus be achieved for an estimated loss to the revenue of some $75 million a year.

2.04 We strongly question the necessity and justice of the income tax increases proposed. The increases would be borne by a group of

citizens who are already heavily taxed and who will face additional tax consequences from the taxation of capital gains. This is the group that contains the ambitious income oriented youth on whose vitality and enterprise the future of the nation depends. These are the individuals who "must be retained or attracted against U.S. competition". They are generally mobile and in the face of a significantly widened gap between Canadian and American tax burdens, the relative attractions of Canada may well become too expensive to hold them.

2.05 We recognize that the question of government expenditures is not the subject of the Committee's consideration. We, nevertheless, think it appropriate to suggest that restraint in spending could be an effective means of avoiding the increased income tax rates proposed by the White Paper. Mr. R.B. Bryce, then Deputy Minister of Finance, when appearing before the Committee on January 20, 1970, made some interesting comments on the relative weight of taxation in Canada and the United States. They arose from a question as to the possible effect of heavier Canadian taxes and lighter American taxes resulting from tax reform in the two countries upon movement of Canadians to the United States. In summary, Mr. Bryce indicated that the average Canadian income can only be 75 - 80% of that in the United States; that in Canada our level of public services and social security is about as high as that in the United States. The result, he said, meant that somewhere our taxes had to be higher than those of the United States and that indeed they are. In these circumstances we are impressed by the very heavy burden of responsibility upon

governments in Canada to ensure that their levels of expenditure are completely justified, for it must be recognized that the goal of a reduced tax burden for one part of the population can be achieved as effectively by expenditure control as by higher taxes for another part of the population. There is also a responsibility on the federal, provincial and municipal governments to co-ordinate their spending and taxation programmes in such a way as to ensure that their impact on the taxpayer is as small as possible. We are not of the opinion that this co-ordination is at present satisfactory. We are disturbed that so much time and effort should be spent on the revision of our taxation structure without an equally careful review of the expenditures of all levels of government in Canada and their sources of revenue, difficult as we realize such an undertaking to be.

2.06 There is one other aspect of the proposed increases in the rate structure which merits consideration. A significant proportion of married women are now regularly employed and their individual incomes are likely to result in a situation where both husband and wife are classified as single for taxation purposes. While the consequences will be dependent on the individual's income bracket, it would seem that the much higher tax increases proposed for single persons would result in a considerably greater burden for many married couples than would appear from a cursory reading of the White Paper. We think that this factor should be taken into consideration in weighing the impact of higher taxes upon the group of taxpayers who will bear the main burden of the proposed rate increases.

2.07 The elimination of one group from the federal tax rolls, a modest reduction in tax for another group and a substantial reduction in the top marginal rates can be achieved, we believe, without the expensive increase in personal exemptions proposed in the White Paper, estimated to cost about some $1 billion annually, and without the increases in the rate structure, estimated to add some $1,255 million annually to the revenue.

2.08 Our reasoning may be summarized as follows: the revenue has already been increased by the proceeds of some $100 million annually from the new taxes on life insurance. Officials appearing before the Senate Committee indicated that this item was not included in the White Paper revenue estimates.

2.09 By the time that legislative changes can be effected, presumably in 1971 if the present target date can be met, wage and salary increases, larger than normal as a result of inflation, will tend to move people for whom tax relief is desired into higher tax brackets and so tend to deny them the intended relief. The relief thus may prove to be less costly then expected.

2.10 The revenue will be further increased by the proceeds of a capital gains tax, net, if our recommendations as to the form of that tax are accepted, of any reductions in revenue from estate taxation. Since we recommend that the proposed increase of personal exemptions be abandoned, the $1 billion estimated loss of revenue would not be incurred. While we are obviously not in any position to estimate closely the effect of changes in taxation policy on the revenue, we do believe that the income tax relief proposed in the

White Paper can be provided, in the light of the above, without an increase in rates of tax.

2.11 The proposals envisage an increase in total revenues at the end of five years of some six hundred and thirty million dollars. This increase has been widely attacked as being unwarranted. If it were avoided the need for tax increases would be reduced.

2.12 Recommendations:

1. Tax Reduction

We recommend that the income tax relief contemplated in the White Paper be provided by changes in the rate structure rather than by the proposed increase in personal exemptions, so that single persons with incomes of $1,400, and married persons with incomes of $2,800, would pay no tax.

2. Additional Personal Exemptions

On compassionate grounds the White Paper proposes to continue the current addition of $500.00 to the personal exemption of those 70 and over and of blind persons and persons confined to a wheelchair. Taking into consideration the fact that the country's social security structure, both public and private, has become geared to retirement at the age of 65, we recommend that the additional exemption of $500.00 should be made applicable at age 65.

GENERAL INCOME AVERAGING OPTIONS

3.01 We consider that the general averaging provisions proposed in the White Paper are quite inadequate to deal fairly with all classes of income gains under the proposed taxation system. They appear to have been transposed almost unamended from the U.S. tax system in spite of the fact that the American provisions were given careful study by the Carter Commission and rejected as inadequate and capricious. Incidentally, the American provisions have been made more generous since publication of the White Paper.

3.02 The basis of our criticism is as follows:

1. There is no provision for averaging of an individual's income that falls below average rather than rises. The Carter Report stated that there should be no restriction on the kinds of income that could be averaged or on the direction of the fluctuations in income (Vol. 3, p. 277). Persons whose incomes fall substantially, because of sickness or accident for example, are surely as entitled to relief as someone who realizes a large capital gain.

2. There is no provision for the carry forward or back of unused personal exemptions or credits. This will be especially onerous for low income groups where income fluctuation takes place around the level of the personal exemption, i.e. where tax begins to apply. Under the proposals the penalty will be increased because:

    (a) The exemptions are greater.

    (b) The lowest marginal rate of 14.8% will rise to 21.76%. The increase in the marginal rate of

tax moving from the zero bracket to the first bracket is in excess of that moving from the first bracket (0 - $500 taxable income) to the eleventh bracket ($13,000 - $16,000 taxable income).

(c) The first bracket has contracted in size.

3. Where top income marginal rates are to be reached at $24,000 per annum, the proposed averaging provisions would be of no benefit to a single person with an average income in the previous four years of $19,125 or a married person with $20,175 or more.

4. The block averaging system is operating in the tax system at present in respect of farmers and fishermen. The White Paper proposes to continue it for these income categories. The failure to extend it to other income categories is surely inequitable.

3.03 Recommendation:

We submit that the "block averaging" system as defined by the Report of the Royal Commission on Taxation, 1966, (Vol. 3, p. 261 et seq.) be adopted with minor modification, as being more effective, fairer and more suited to the Canadian tax environment.

3.04 Further Comments:

(a) We do not consider that deposit averaging using income adjustment accounts is essential to the introduction of a block averaging system.

(b) We believe that the option to re-average at death should be included if death should be regarded as a disposal for capital gains tax purposes.

(c) We consider that general averaging provisions should extend to all individuals and entities presently taxed as individuals, e.g. estates and trusts.

(d) The present piecemeal system of averaging affords special relief to some types of income but, with the prospect of a capital gains tax, it is not equitable or adequate for general application. We believe that certain of the present provisions in the Income Tax Act dealing with irregular payments, etc. should be continued to supplement the general averaging system. These provisions have been evolved as a result of long experience and they should not be discarded unless plainly redundant.

PENSION PLANS AND RETIREMENT SAVINGS PLANS

4.01 The role of corporate trustees for pension and retirement savings plans includes several functions. Their main responsibilities are to manage the monies entrusted to them by corporations and individual savers. Their services include the effective investment of trustee monies, in accordance with applicable federal and provincial laws and regulations governing such plans, safekeeping of the assets, administration and accounting control of the funds in their care, responsibility for correct withholding of taxes, and ensuring that each disbursement is properly made.

4.02 At the end of 1968, the Dominion Bureau of Statistics reported there were 4,065 trusteed pension plans in Canada. Over 72% of the funds of these plans were managed by corporate trustees. The assets held at the end of 1969 by trust companies belonging to our Association totalled approximately $4 billion and covered better than one million taxpayers. We are gratified that the government believes it to be desirable to encourage personal savings for retirement and to continue to support the tax-free status of trusts created as investment vehicles for such savings.

4.03 Section 2.52 of the White Paper states that rules are required to ensure that the trustees of a pension or registered retirement savings plan fund are liable and responsible for paying taxes arising out of its operations. Corporate trustees have always taken seriously their responsibility for the deduction and remittance of income tax on withdrawals from pension and retirement savings plans.

4.04 <u>We recommend that the obligations of trustees regarding the tax liabilities of beneficiaries</u>

should not extend beyond the deduction of taxes required to be withheld by trustees.

4.05 In 1954 the contribution limit for registered pension plans was increased from $900.00 to the present $1,500.00. The contribution limit for registered retirement savings plans is $2,500.00. The loss of purchasing power of the Canadian dollar has been such as to justify a major upward revision of these limits.

4.06 We, therefore, recommend that the contribution limit for registered pension plans be increased to at least $2,500.00, and that for registered retirement savings plans to the lesser of $4,000.00 or 20% of income.

4.07 Regarding pension plans for employee-shareholders who are bona fide employees:

We recommend that such plans should be permitted registration if they meet all the prescribed benefits and investment standards for registered pension plans. We agree that abuse should be controlled, but that such employees should not be denied retirement consideration or be discriminated against.

4.08 The White Paper proposes that, in order to qualify for tax-free status, pension and retirement savings funds must invest no more than 10 per cent of their assets in foreign securities or other foreign investments. We believe the arbitrary selection of a 10 per cent limitation will seriously affect the pensions of a great many Canadians. By limiting the investment horizons of Canadian pension plans, the opportunities to increase long-term investment return through astute

portfolio management are inhibited, with resulting impact on the amount of pension available at retirement and on pension costs.

4.09 We recommend that if the proposed type of restriction is applied, such percentage limitation on foreign holdings should be considerably higher than 10 per cent, certainly no less than 20 per cent. The limit should be expressed as a percentage of book value of assets to provide ease of control and inspection. So as to avoid any unnecessary penalty incurred by the forced sale of such securities, we are firmly of the opinion that any investments made in good faith by the trust fund in such securities prior to implementation of any new investment restrictions, should be permitted to continue to be held by the trust fund, subject to a transitional period of at least five years to permit orderly phasing-into such new regulations. The Minister should have discretion to allow an extension of such transitional period where special circumstances would justify this.

4.10 We recommend that transfer of lump sum payments between registered pension and retirement savings plans, should be permitted to continue as at present.

4.11 The government proposes to tax, at full rates, amounts withdrawn at the death of the contributor. The widow would be permitted to offset or reduce the taxable income if she contributes the proceeds, in whole or in part, to a registered retirement savings plan of her own.

4.12 <u>We recommend that this option also be available to a widower.</u>

4.13 <u>We recommend that lump sum payments resulting from death or termination of membership in registered pension or retirement savings plans, should receive identical treatment for tax purposes and should not be taxed at full rates.</u>

4.14 The above recommendation is based on the premise that no taxpayer or beneficiary should have to pay an amount of tax on such withdrawals, which amount of tax is in excess of the accumulated tax savings during the period of accumulation under the plan.

4.15 <u>We recommend that, in respect to these pay-outs from either pension or retirement savings plans, if a form of averaging is introduced affecting such withdrawals, the actual tax payable should not be in excess of that payable under the three-year averaging provision of Section 36 of the present Income Tax Act.</u>

4.16 <u>We recommend that pooled or commingled investment funds restricted to non-taxable pension trusts and retirement savings funds operated by corporate trustees, should not be classed as "widely-held corporations" within the meaning of section 5.56 of the White Paper.</u>

4.17 Investment in these pools is presently restricted to non-taxable registered pension or retirement savings plans. The "units" of such pools are not transferable in any way and can be acquired or redeemed only by the corporate trustee from the pool for each

participating pension fund or retirement savings plan administered by such trustee.

CAPITAL GAINS TAX

5.01 In Part I - General of this brief, we summarize our general objections to the proposals contained in Chapter 3 of the White Paper for taxing capital gains. In this paper, we deal with the various aspects of the capital gains proposals and provide what we consider to be preferable alternatives.

An alternative Proposal

5.02 We recommend:

1. that, with the possible exception of short-term gains, capital gains should not be taxed as income, but at one-half of marginal rates, with a maximum rate of 25%. By short-term gains we mean gains realized within six months of the date of acquisition of the investment in respect of which they arise.
2. that principal residences be exempt or, failing that, that the annual allowance be substantially increased to a point where there is no likelihood that a sale, in normal circumstances, of a principal residence would attract capital gains tax.
3. that other property held for personal use and enjoyment be exempt if the proceeds of sale do not exceed a value of $5,000 for each asset.
4. that the proposed five year deemed realization of the shares of widely-held Canadian corporations be abandoned. Elsewhere in this brief we recommend abandonment of the distinction between "widely-held" and "closely-held" Canadian corporations.

5. that death be treated as a disposal and capital gains be considered to be realized, subject to an exemption if gains do not exceed a stipulated amount, say $15,000.

6. that estate tax be phased out upon the introduction of a capital gains tax if the tax, as we suggest, treats death as a disposal.

7. that the recipient of a testamentary gift be treated as if he had purchased the asset representing the gift at fair market value rather than, as is proposed in the White Paper, being treated as having acquired the asset at its original cost to the deceased.

8. that gifts between spouses should have no capital gains tax consequences. If this recommendation is rejected and there are to be such tax consequences, we recommend that section 21 of the Income Tax Act be amended, should that be necessary, to provide that when there is a deemed disposal on the occasion of a transfer of assets from one spouse to another, the latter being liable for tax, subsequent gains either actual or deemed should be taxable in the hands of the donee spouse.

9. that if there is to be a deemed disposal for capital gains tax purposes, in the case of a gift, the capital gains tax paid should reduce the value of the gift for the purpose of assessing gift tax.

10. <u>that capital gains tax be payable only on the disposal of an asset: that there should, for example, be no deemed realizations on departure from Canada, and</u>

11. <u>that a weighted average cost be used in calculating base price for capital gains tax on the sale of a holding of a specific security that has been accumulated at varying prices since valuation day</u>. <u>Valuation day base for marketable securities be subject to an increment (say 10%) to broadly compensate for inability to use cost as base and for any possible market depression</u>.

5.03 These are broad recommendations which we believe to be soundly based on the realities of the Canadian economic and social environment. Our Association does not have the resources to draft a proposal for capital gains tax in all its technical detail, nor is it desirable that we attempt to do so. We strongly hope that the Committee will recognize the shortcomings of the White Paper proposals as we see them and carefully weigh our alternatives. In making our suggestions we have kept in mind the necessity to adopt principles which would make drafting and administration as simple as possible. Our reasoning for our recommendations follows.

5.04 We believe the taxing of capital gains at income tax rates is not a reasonable proposal because:

(a) it accepts the premise that a dollar gained by capital increase should be taxed at income tax

rates regardless of the element of risk involved in the investment. Indeed the rate of tax is modified for investment in "widely-held" Canadian companies where the entrepreneurial risks are less than those for companies and individuals to be taxed at full marginal rates.

(b) such taxation would be excessive in relation to the tax on gains imposed by our principal international trading partners. Canada is a capital importing nation and if it needs to continue to import capital, the tax should be relatively lighter than that of nations which are more fully developed or do not have the same need for capital. The exceptionally high rate may well complicate treaty negotiations.

(c) the full marginal rates take no account of the effect of the rate of inflation on asset values. The longer the asset is held the more serious this problem is likely to become. If the introduction of an "inflation factor" to the tax is politically difficult, a reduction in the proposed rates would achieve essentially the same effect.

(d) to impose a capital gains tax at this unprecedented rate in an economic environment that has had no capital gains tax would result in too great an economic disturbance. We believe that it would be

rational to impose a more modest tax and gain some experience with it.

(e) by merging income and capital gains and losses the taxpayer would properly have the right, under the proposals, to deduct capital losses from income. We think this could have a severe effect on national revenue in a deflationary period. We believe capital losses from all sources should be deductible from capital gains with a provision for carry forward, but that capital losses should not be used to reduce income. This, however, could only be acceptable if capital gains were not treated as income.

5.05 The benefits accruing to a nation from home ownership are self-evident and Canadian governments have provided much encouragement to home ownership by such means as the National Housing Act. It, therefore, seems to be unfortunate, particularly in the midst of serious housing problems, that the White Paper should propose that principal residences should be objects of capital gains taxation. The expressed desire of the Minister of Finance not to tax Canadians on the sale of their principal residences under normal circumstances can best be accomplished by excluding all such residences from tax.

5.06 We have little doubt that there is a strong desire on the part of the Department of Finance to bring under tax any gains reflecting sales of principal residences at considerably more than current market values, a circumstance which is most likely to arise from redevelopment projects. We question that the proposed administrative

burden and other difficulties which would be created by taxing principal residences in general, would be warranted by the amount of revenue likely to stem from the taxation of those relatively few sales made possible by redevelopment. If the Finance Department is determined that the individual who sells his principal residence for redevelopment simply cannot be allowed to escape the capital gains tax net, we would urge that it is not beyond the ability of the drafters of legislation to arrange to levy the tax in such a way that other, more normal sales, which are enormously in the majority, would not be affected.

5.07 In its consideration of the application of capital gains tax to principal residences we hope that the Committee will have regard to what may be described as the "sifting-up process". This is the very prevalent process in housing of the continual up-grading to higher priced houses as owners gain in economic power. Any attempt to define in dollars the "average principal residence" will adversely affect this process, which also provides lower cost housing. It should not be inhibited.

5.08 The White Paper proposes that personal assets such as pictures, furniture and jewellery be exempt from gains tax if the proceeds of sale do not exceed $500.00. If the proceeds do exceed $500.00, there can be deducted from them either the cost or $500.00, whichever is the greater. It is expressly stated that this provision is intended to prevent Canadians from becoming a nation of bookkeepers. Our contention is that we shall indeed become a nation of bookkeepers if we set the exemption level at $500.00. <u>We recommend that it be set</u>

at $5,000.00. This should exempt the tangible moveable possessions of a middle income Canadian family, but is low enough to embrace those possessions such as jewellery or paintings that may have been acquired with substantial investment motives. Surely the cost of administering a gains tax on physical possessions worth less than $5,000.00 will outweigh the revenue involved. The U.K. capital gains tax, which is considerably more elaborate than Canada should adopt, excludes tangible moveable possessions where the proceeds of sale are less than £1,000, and provides marginal relief.

5.09 Section 3.41 of the White Paper does not indicate clearly the capital gains tax consequences of a gift from one spouse to another. No indication, however, is given in the section that such a gift between spouses would be exempt from capital gains tax.

5.10 It is our understanding that when estate and gift tax legislation was recently amended the principle was established that there should be no tax consequences as a result of gifts between spouses. We, therefore, take the position, which we think is in accordance with the philosophy of the changes in estate and gift tax legislation, that there should be no capital gains tax consequences in connection with a gift between spouses.

5.11 As regards gifts other than those between spouses, we note the existing high rates of gift tax leviable and the cumulative feature of the tax. In the light of these, we claim that the imposition of a capital gains tax on such gifts is unwarranted. In extreme cases the imposition of both taxes could result in a total levy in excess of the value of the gift.

5.12 One of the most criticized and undesirable proposals in the White Paper is the deemed realization at five yearly intervals of the shares of "widely-held" companies. Such a proposal represents a departure from the accepted concept that before a gain or loss is assessed for tax, a disposal or realization should take place. The proposal has rightly been declared a capital levy; a wealth tax rather than a capital gains tax. As an attempt to reduce "lock-in" it is crude, and is something of a bludgeon to deal with a problem of modest proportions. We contend that there are better ways to deal with the problem of "lock-in".

5.13 The distinction between "widely-held" and "closely-held" companies is an artificial one at best. There can be no equity when it forms the basis for making or not making a capital levy every five years. To the potential investor, who has a wide choice of Canadian and foreign securities, the shares of widely-held Canadian corporations would, as a result of it, become less attractive.

5.14 The Minister of Finance's paper on the subject outlined some of the possible undesirable effects:

(i) The problems taxpayers would face in finding cash to pay tax on the unsold shares and the possible loss of Canadian control thereby.

(ii) The disincentive for "closely-held" companies to go public and the incentive for them to sell out completely - probably to foreigners.

(iii) Foreigners could outbid Canadians for shares in Canadian corporations. Foreign parent companies

would be discouraged from making stock of their wholly owned Canadian subsidiaries available to Canadians, thus creating inequities between those who had already done so and those who had not.

5.15 Additionally, we foresee costly problems of workability for our own industry, in valuing each client's separate portfolio on the quinquennial birthday, carrying such values and amending them to weighted averages continuously. The data can be recorded on our computers but it is costly to do so and the information would serve no other purpose than computation of the capital levy.

5.16 We therefore recommend the abandonment of the proposed deemed realization of shares of "widely-held" corporations as set out in the White Paper.

5.17 The Minister of Finance has asked for alternative suggestions for the treatment of capital gains and we propose an alternative to the quinquennial valuation in the next paragraph, 5.18, and 5.04 (e), where we indicate that capital losses should not be deductible from income.

5.18 We believe that capital gains tax should be assessed only upon the disposal of an asset. It would be consistent with this position to treat death as resulting in a disposal. The capital gains tax arising from such a disposal should be regarded as a debt of the deceased and, as income tax liability is at present, a deductible expense for the purpose of determining aggregate net value for estate tax purposes. Concurrent with the introduction of a capital gains tax at death, estate taxes should be phased out. Under such circumstances

<u>we would recommend that the rates of gift tax be appropriately reduced</u>. We do not recommend complete phasing out of gift taxes in the light of their purpose of protecting revenue derived from income tax.

5.19 Our reasons for the recommendation are as follows:

(a) It precludes the passing from one generation to the next of possibly huge capital gains tax liabilities which could produce a "lock-in" that the White Paper proposal seeks to avoid. Estates administration could be unnecessarily complicated by such contingent liabilities to tax.

(b) Under the White Paper proposals forced realizations of assets to pay death taxes could create confiscatory tax loads and inequities between estates. This possibility would be reduced under our recommendation whereby the tax load on death could be made reasonable by co-ordination of death tax and capital gains tax rates, i.e. a testator who had planned his estate to have sufficient liquid resources to meet death taxes would not be forced into realizations that might compel him to incur capital gains tax.

(c) Death taxes should be eliminated because, with capital gains tax, the combined load would be plainly excessive. Death taxes produce a relatively modest proportion of total government revenue which is further diminished by heavy collection costs. The gift tax should be lightened

at the same time to the extent that it would no longer be needed to prevent avoidance of estate tax.

(b) The elimination of death taxes would be a means of attracting capital to Canada in a way that offends no foreign treasury and does not give rise to treaty problems. It should give rise to increased revenues from income and capital gains taxes sufficient to outweigh any loss due to the elimination of death taxes.

(e) Death taxes are powerful disincentives to personal enterprise and effort - out of all proportion to their revenue yield. The desire to accumulate wealth to provide a better environment for the next generation is behind much of our individual and collective effort. Death taxes directly oppose that desire. Taxes levied when income is earned, or gains realized, are more tolerable and less of a disincentive if the taxpayer is left to dispose of the balance as he wishes.

5.20 The proposal to levy a capital gains tax upon departure from the country appears to us to introduce a new principle into national and international taxation. It would seem to be in contradiction to the reality of our position in the economic world. Canada has a growin economic status, not a declining one, and does not warrant such a defensive proposal. Our fiscal policy in the past has recognized that our need for growth should encourage skilled people to come to this

country with their capital. They will not do so if the country takes on the characteristics of a trap and they cannot leave without heavy financial penalty. The damage of such a proposal far outweighs the misplaced motive of equity that has engendered it.

5.21 We recommend the use of a weighted average cost in calculating base price for capital gains tax on the sale of a holding of a specific security that has been accumulated at varying prices since valuation day. This method of calculating the base price would obviate the necessity of maintaining permanent records of security identification (i.e. certificate numbers) and cost and date of purchase. It would appear to simplify the inventory recording problems of the large portfolio managers, such as ourselves, and the reporting problems of the small investor who might have difficulty in matching a sale to a specific purchase.

.22 It should be kept in mind that:

(a) the provisions of the White Paper would necessitate maintaining prevaluation day cost details for bonds and mortgages.

(b) if the five year revaluation of "widely-held" company stocks remains, the weighted average cost will be subject to amendment to market on each quinquennial birthday. Such an inventory valuation would necessitate costly duplication as it would have no value beyond the computation of the capital levy.

23 We do not advocate the complicated concessions applicable to the introduction of capital gains taxation in the U.K., necessitating

the maintenance of cost and identity detail for every security holding and the operation of the "first in, first out" rule. Instead we submit that in computing a capital gain a percentage, say 110% of the valuation day market value, be used as base price. This would provide the necessary cushion to the introduction of the tax and moderate any inequities that result from depressed valuation day prices.

INTEGRATION

6.01 The White Paper proposes total integration of corporate and personal taxes for that class of corporation which it describes as "closely-held" and partial integration for another class of corporation which it describes as "widely-held". The two proposed classes of corporations would receive quite different tax treatment.

6.02 We agree that there should be provision in the Income Tax Act to eliminate or at least reduce double taxation and we agree with the White Paper assessment that the existing dividend tax credit "is a rough and ready method of off-setting corporate tax". While recognizing that the present credit is worth more to higher rate taxpayers and that the arrangement is therefore lacking in equity, we doubt that the equity aspect is in practice very serious.

6.03 We can commend the White Paper proposals on integration in seeking to alleviate double taxation of corporate income in the hands of individual shareholders. The incidence of corporate tax is a matter of much debate. For this reason, if no other, we accept that provision of a tax credit to the corporate shareholder must, in all probability, be somewhat arbitrary in its design. The proposals of the White Paper represent a commendable effort to ease tax burdens on the shareholders of closely-held corporations, although we cannot see that there is justification for the distinction in the White Paper between the two kinds of corporations, based on the assumption of different competitive environments. We are inclined to think that revenue considerations may have been an important factor in deciding to propose the distinction.

6.04 In our opinion the integration proposals of the White Paper,

which are complex and difficult to assess in terms of their results, fail to achieve the goal of an acceptable alternative to the existing dividend tax credit arrangement. There seems to be little doubt that adoption of the proposals would result in complicated and involved legislation and regulations.

6.05 We do not think that corporate taxation should lead business organizations into significantly artificial decisions or actions. All corporations, other than those which choose the partnership option, should be treated simply as corporations without the distinction between closely and widely-held, since they both operate essentially in the same competitive arena. The proposed distinction between closely and widely-held corporations would produce artificial factors of strictly tax consideration in the making of decisions as to whether or not a company should "go public".

6.06 There would undoubtedly be much pressure on corporations to make distributions, yet retained surpluses are vital for essential reinvestment. Corporate savings are most important in the private sector and certainly should not be discouraged.

6.07 It seems inevitable that there would be shareholder conflicts, and sometimes serious ones, as to the distribution within the two and one-half year period of earnings by dividend or stock dividend. Differences arising from the self-interest of resident and non-resident shareholders and between those in higher or lower tax brackets would cause some of such conflicts.

6.08 The proposed system of integration would encourage equity investments in the shares of mature corporations with established

dividend payments and would discourage investment in risk undertakings offering little or no early prospect of dividend payments.

6.09 Various incentives are offered by government, using a variety of techniques such as accelerated depreciation, cash grants, etc., but all designed to encourage corporations to undertake some activity or to operate in some area. Examples would be scientific research, creation of jobs in designed areas and others. We are concerned lest the integration proposals adversely affect, by taxation of shareholders, some or all of these programmes.

6.10 Income flows between Canadian corporations should continue to be tax-free as at present. If this is not to be the case there would likely be some complex restructuring of corporate enterprises to cope with the incidence of tax as income flows between various corporate vehicles. We see no reason for disturbing the existing tax-free inter-company distributions except that of accommodating tax legislation.

6.11 The proposal for integration, as it stands, is discriminatory in that:

(a) non-resident investors will not be able to recover creditable tax. We have explained our opposition to this particular discrimination elsewhere and we expect the proposal would lead to treaty negotiation problems.

(b) 95% of corporation tax on privately owned utility companies is paid to the provinces and the shareholders of such companies would not be eligible under the

proposals for tax credits. The companies thus would be handicapped, relative to other corporations, in the capital market and their shareholders would be discriminated against in their tax treatment.

(c) Tax-exempt trusts - such as Registered Pension Plan and Registered Retirement Savings Plan trusts will not be entitled to recover creditable tax and will be at a disadvantage in this respect relative to other resident investors.

6.12 The above is a far from complete criticism of the details of the integration proposal, the complexities of which have created considerable differences of opinion and reaction among those to be considered best fitted to judge it.

6.13 For the above reasons we believe that the White Paper's proposals for integration should be reconsidered in detail with the object of removing the complications, artificialities and discriminations which they would produce in legislation.

6.14 We therefore recommend:

1. that the proposed distinction between closely and widely-held corporations be abandoned.
2. that income flows between Canadian corporations continue to be without tax consequences.
3. that the proposed rule regarding distribution of profits within a two and a half year period be abandoned.
4. that the concept of employing credits to share-

holders to reduce or eliminate double taxation be embodied in arrangements that provide simplicity even if that is done at some cost to theoretical equity.

PROPOSED ABOLITION OF TWO RATE STRUCTURE OF CORPORATIONS TAX

7.01 The White Paper proposes that the lower rate of tax currently applicable to the first $35,000 of a corporation's taxable earnings should gradually be withdrawn over a period of five years.

7.02 We are aware of the administrative and other difficulties which attend the existing two rate structure and recognize the appeal of a single rate. But we are, like many others, seriously concerned about the impact that the course of action proposed is likely to have upon small businesses.

7.03 It is, we believe, important for the economic well being of the country that there should exist reasonable means to encourage development and growth of small business. To the extend that financial assistance to meet bona fide needs of small business is necessary, we are convinced that it should be readily available.

7.04 We therefore recommend that implementation of the White Paper's proposal be conditional upon the provision of alternative means of financial assistance to small business. Such means might take the shape of:

(a) expansion of the small business loan programme of financial institutions;

(b) broadening of the loaning practice of the Industrial Development Bank;

(c) a tax deferral scheme;

(d) accelerated capital cost allowances;

(e) inventory reserve allowances;

(f) a preferential tax rate not available beyond a fixed limit of gross income.

ENTERTAINMENT AND RELATED EXPENSES

8.01 The proposal that no deduction be permitted in respect of entertainment expenses, the costs of attending or sending employees to conventions and the cost of dues for membership in social or recreational clubs, seems to us to run counter to the widely accepted principle that an expenditure incurred for the purpose of producing income should be deductible for the purpose of arriving at taxable income.

8.02 We recommend that this proposal not be carried into effect since we believe that instances of abuse that may arise in a situation in which entertainment and related expenses remain deductible can be adequately curbed by the use of existing provisions of the Income Tax Act.

INVESTMENT INCOME OF CLUBS AND OTHER NON-PROFIT ORGANIZATIONS

9.01 Section 62(1)(i) of the Income Tax Act exempts from income tax "a club, society or association organized and operated exclusively for social welfare, civic improvement, pleasure or recreation, or for any other purpose except profit ....". We assume that trade associations, such as our own, would be included in the phrase "for any other purpose except profit". However, we draw to your attention that under Section 62(1)(d) agricultural organizations, Boards of Trade and Chambers of Commerce at the present time receive the same exemption from the payment of income tax. Paragraph 5.54 of the White Paper proposes to tax the investment income of the organizations covered by Section 62(1)(i) and this would produce a distinct inequity, since Boards of Trade and Chambers of Commerce perform essentially the same function and exist for essentially the same purposes as trade associations. In one way or another each exist to further the interests of the section of the business community which it represents. There has, of course, been no point in the past in organizations such as ours seeking any change in 62(1)(i) or to suggest that we come under 62(1)(d), since no tax consequences flow from the existing situation.

9.02 We recommend that 62(1)(d) be amended in such a way as to include bona fide trade associations under that subsection and so continue to free them from any taxation of their investment income which, with relatively few exceptions, is not significant.

TRUSTS

10.01 It is appreciated that the White Paper specifically draws attention to a lack of knowledge of the use of Trusts and requests particular submissions in this regard. In view of the limited period of time available, it is not possible for us to prepare a full submission with all the supporting statistics which must be produced to demonstrate adequately the place for and use of Trusts in this country. Taxation of Trusts does not appear, from the Revenue Tables given in the Paper, to have any significant effect on the revenue and, therefore, we feel that a delay in implementing changes in tax legislation dealing with Trusts would not have any prejudicial effect on either the public or private sector. We would consider allocating the time, effort and resources required for a major study if consultation with the authorities appears to justify the considerable expenditure involved on our part and if agreement can be reached to delay amendments to the Income Tax Act which would affect Trusts until the study can be completed and made available. We expect the study could be brought in within a year.

10.02 In the meantime, however, there are some observations to be made about the sections of the White Paper dealing with Trusts. We feel the authors should not have suggested any reform in the taxation of Trusts until the subject has been properly researched. The use of the word "loophole" and the all-embracing expression "other Trusts" in section 5.57 could easily convey to the general reader the impression that Trusts are some device recently invented to take advantage of inadequate drafting in the Income Tax Act. The concept of the Trust has been described and is recognized as one of the great developments

has been used deliberately to illustrate the pitfall which can be created by suggesting common or uniform taxing measures to be applicable to any property which bears the imprint of a Trust.

10.04 The purposes for which Trusts can be created are as unlimited as the imagination of lawyers. There are no technical rules restricting the creation of Trusts. The Trust can be and has been applied as a device for accomplishing many different purposes. One of the most important is, and always has been, the making of family settlements. Through the Trust it is possible to separate the benefits of ownership from the burdens of ownership. The whole responsibility for the management of the property is thrown upon the trustee. The Trust has been frequently employed in business transactions. Trusteeship has become a readily available tool for everyday purposes of organization, financing, risk-shifting, credit operations, settling of disputes and liquidation of business affairs. Next to contract and incorporation, the Trust takes its place wherever the relations to be established are too delicate or too novel for those coarser devices. The business Trust has been used extensively as a substitute for incorporation, as is the case, for example, with the Canadian Depository for Securities at present in the process of organization. The Trust has been frequently employed in real estate transactions, as in the case of office buildings, suburban sub-divisions, co-operative apartment houses, and the like, where there are difficulties in the way of splitting the legal ownership. The Trust has been used as a security device, as in the case of assignments for the benefit of creditors, and what is much more important, as in the case of the issue of corporate bonds secured by deed of Trust. It has been used for other business purposes, as in the case of Voting

Trusts, Equipment Trusts, Investment Trusts, and Trust Receipts. Through the Trust, it is possible to devote property to purposes of charity, or unincorporated associations of a social nature. However, there are very restrictive rules applicable to the operation of Trusts once created; e.g. rules restricting the period of accumulation: rules against perpetuity which limit the time a Trust may postpone the vesting of assets.

10.05 Probably no legal term can be defined with such perfect accuracy as to include all that is intended to be included and to exclude everything else. This is particularly true of a legal concept as elusive as the Trust. Even if it were possible to frame an exact definition of it, the definition would not be of great practical value. A definition cannot properly be used as though it were a major premise from which rules governing conduct can be deduced. Our law has not grown in that way. In the development of the Trust concept in English law, the rules as determined by the decided cases came first so that the definition results from the rules, and not the rules from the definition.

10.06 All that one can properly attempt to do is to give such a description of the legal concept as will enable others to know in a general way what one is talking about. It is possible to state the principal distinguishing characteristics of the concept so that others will have a general idea of the meaning:

> "A Trust is a fiduciary relationship with respect to property, subjecting the person by whom the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result

of a manifestation of an intention to create that fiduciary relationship." (Ref. "Scott on Trusts", Vol. 1, Page 36.)

10.07 It is obvious then that before any reasonable dialogue can be carried on about the proper and equitable way in which tax legislation should affect Trusts, considerable research must be done so that the myriad uses and forms of Trusts can be recognized and distinguished. What may well be fair and equitable tax treatment for one type of Trust may not be for others.

10.08 Under the present provisions of the Income Tax Act, no distinction is made as to the type of Trust being reported. The present Act recognizes the conduit principle of allocation of income and this, we believe, is a basic element which should be retained for those Trusts which might be defined as pure Trusts.

10.09 The present Act allows a Trust, when computing its taxable income, to deduct from gross income that portion thereof which is either paid, or is payable, to a beneficiary in the year. The beneficiary must include in his income the amounts paid or payable in the year and pay tax at personal rates. Even if the income is not paid to the beneficiary in the year in which it is earned, but is nevertheless payable to him, he pays tax on it in that year and not in the subsequent year when he actually receives it. This provision was specifically designed to ensure that the Revenue Department could assess and collect tax on Trust income as earned and to prevent accumulation of tax-free earnings in Trusts. The provision has proven equitable both for the taxpayer and National Revenue, and we recommend its retention.

10.10 In view of this, we find the statement in 5.56 of the White

Paper - "many Trusts do not pay any tax at all" to be misleading. It might be said of partnerships that "because a partnership is not taxed on income which is payable to the partners during the year, many partnerships do not pay any tax at all".

10.11 Under the Act, all partnership income is allocated to the partners and is taxed at each partner's individual rate.

10.12 Under the Act, all Trust income distributable is allocated to the beneficiaries and is taxed at each beneficiary's individual rate.

10.13 Section 4.19 of the White Paper points out that "the closely-held corporation competes with proprietorships, partnerships and, of course, with other closely-held corporations, while the public corporation competes with other public corporations, both Canadian and foreign".

10.14 Then, in Section 5.56, it is stated that "Some of these Trusts are in direct competition with widely-held public corporations and have as many beneficiaries (in this case usually unitholders) as some public corporations have shareholders". Unfortunately, "these trusts" are not defined and we can only conjecture as to the type of Trust being singled out, which we attempt to do in our technical paper 10A, entitled Investment Fund Trusts. This again points up the necessity to distinguish between the various types of Trusts. There are probably at least six major, broad classifications into which Trusts used in Canada fall.

10.15 1. <u>Testamentary Trusts</u>

These arise on death and are Trusts established by the Will of the deceased. As opposed to the estate being immediately wound up

on the death of the testator and the assets distributed to the beneficiaries, the estate assets, after debts, taxes, and specific legacies, are held by a trustee named in the Will, subject to the conditions of the Trust terms set out in the Will. The most common case requires that the assets be held by the trustee to produce income for the widow until her death, and upon her death that the trustee distribute the then assets amongst the children. An additional provision usually specifies that if any child is at the death of the widow under the age of 21, the child's share is retained in Trust by the trustee until the child attains 21.

10.16 This is the basic form of Trust Will. Certain variations and extensions may be attached to the basic form to fit individual family circumstances. The foundation of these Trusts is asset protection and management. Under the present provisions of the Estate Tax Act there is neither a tax saving to, nor an additional tax burden on the creator of such a Trust. Under the present provisions of the Income Tax Act, all income earned by the Trust is allocated and paid to or on behalf of the widow and she pays income tax on it at her personal rate. We strongly urge the retention of the present provisions applicable to such Trusts as being equitable to both the general public and government revenues.

10.17 Trust Wills are rarely drawn for estates under $50,000 because to provide a reasonable annual living allowance for the widow, the trustee would have continually to draw on the capital of the fund making a viable investment programme very difficult.

10.18 The larger the estate, the more likely it is to contain Trusts. Again, regardless of the size of the estate, there is no

particular tax advantage under the present Estate Tax Act or Income Tax Act to establish Trusts. They are established for protection and management purposes.

10.19 2. Intra-Company Trust Funds

These are called Common Trust Funds or Pooled Trust Funds.

10.20 The average size of the personal and testamentary Trusts being administered by Trust Companies in Canada will be less than $150,000 net. Many will be less than $50,000 net. In order to provide small Trusts with the same degree of diversification and additional protection that larger accounts have, some companies have, where provincial legislation permits, established Common or Pooled Funds.

10.21 Only accounts under the administration of the particular company are permitted to participate. They are not open to the public, but are purely internal.

10.22 The particular Trust purchases units in such a fund at a market value established at frequent intervals, and all income earned by the fund is allocated at regular intervals to the participating Trusts. No fee is charged for the administration of the fund. The resulting income credited to the individual Trust is distributed in accordance with the terms of the Trust instrument to the beneficiaries and is reported as taxable income as in an ordinary Trust.

10.23 These funds have, and should have, no tax consequence. They are simply a highly efficient administrative function providing benefits for individual Trusts which the Trusts could not otherwise obtain: e.g. - wider bond or market participation, higher yields, no brokerage cost, diversification, high liquidity.

10.24 3. Personal Trusts

These are distinguished from the Trusts dealt with in Section 4 because they are purely personal and generally have no business purpose connection. That is, their "raison d'être" is not founded upon, or required by, any commercial involvement. They would include: marriage settlements; divorce settlements; Infants Protection Trusts; Trusts for the physically or mentally incapable; spendthrift Trusts; Life Insurance Trusts; Inter-vivos Gift Trusts; and so on.

10.25 Some of these have tax effects: others do not. For example, there is usually no tax consideration in the establishment of Trusts for marriage settlement; divorce settlement; infant protection; mentally or physically incapable; or for spendthrift Trusts. Rarely is the resulting tax consequence given any consideration whatsoever by the settlor. Some civil matter has arisen which requires asset management to be performed by a third party (the trustee) for the benefit of an individual who is incapable, or legally or contractually prohibited from dealing with the assets directly. Only a Trust will serve the function.

10.26 Others do have tax consequences and in many cases the settlor is very much aware what those consequences will be.

10.27 Life Insurance Trusts are designed to permit the settlor to make cash settlements to the trustee, who is authorized to invest with a very broad investment power. The trustee may decide to apply for a life insurance policy on the life of the settlor and to pay the premiums from the cash settled in the Trust. The right of the Trust

beneficiaries to receive benefits from the Trust is distinguished from the date of death of the settlor and is usually contingent upon some other event; e.g. - the date of the twenty-first birthday of the youngest beneficiary or some similar event. Such a Trust can have an estate tax saving for the settlor. Usually there is no income flow so that income tax is not affected.

10.28 Inter-vivos Gift Trusts or Inter-vivos Trusts for estate planning purposes may be designed to have tax saving features. It should be strongly emphasized that tax saving is not always the sole criterion, but it is possible there can be a tax consequence of some benefit to the settlor. In that a settlor can by the use of a properly drafted Trust, divorce himself of assets or cash, he may affect his own income tax position. But, if the Trust beneficiary is a wife, or a child under 19, the income earned in the Trust is attributable to the settlor under the present provision of the Act and no income tax saving can result.

10.29 It should be noted that as a result of the 1968 Estate Tax and Gift Tax amendments whereby gifts are taxed on a cumulative basis and the gift tax rates dramatically increased, the use of these Trusts has been effectively reduced since the tax cost is now for all practical purposes prohibitive. We cannot see that such Trusts are now in any way a threat to government revenues and we urge retention of the present provisions applicable to them.

10.30 4. Personal Business Purpose Trusts

These include partnership Buy-Sell Agreements, usually funded by insurance held by a trustee; Stock Purchase Agreements - some of

which are funded by insurance held by the trustee, but in which, in any event, the stock is held in trust by the trustee; Business Sale Trusts in which the assets of the business are pledged by the purchaser to the trustee until full payment has been made to the vendor; Stock Voting Trusts and so on.

10.31 There is no tax consideration involved in the setting up of these Trusts. They might be described as pure "Holding" Trusts in that the Trust has no function other than to hold assets until the happening of certain events, or to act as intermediary between the parties. Such Trusts have no effect one way or the other on tax revenues and should be distinguished in any tax reform proposals.

10.32 5. Business Trusts Having Personal Purposes

These would include such uses of the concept as Pension Fund Trusts; Employee Benefit Trusts; Profit Sharing Trusts; Registered Retirement Savings Plans.

10.33 The expression "personal purposes" is used to distinguish these Trusts from the more commercially oriented Trusts described under the following heading. The Trusts under Section 6 might be said to exist for the commercial purpose which they cover. These Trusts have a personal purpose for an individual which is separate from any commercial object, even though the root relationship between the individual and the Trust is based on a business or commercial concern.

10.34 Tax treatment of these Trusts is contained in other sections of the White Paper and need not be commented on here except to point out that the reform proposals, therefore, already distinguish between types of Trusts for the purpose of tax consideration.

10.35 All such Trusts are required to be registered for income tax purposes and the "policing" requirement to eliminate tax avoidance schemes becomes relatively simple.

10.36 6. Business Trusts

These would include such uses of the concept as Corporate Trusts under bond financing arrangements; Investment Fund Trusts or Unit Trusts; Syndicate Trusts; Stock Escrow Trusts and so on. Investment Fund Trusts, because of their variety and of the important implications of the White Paper proposals for them, are dealt with in a separate paper, 10A.

10.37 All these Trusts have been established and used as Business Interests Trusts. An example of a Syndicate Trust would be one formed by a group interested in promoting a mining exploration venture. Such a Trust is neither designed nor intended to give any tax benefit to the individuals. It is intended to provide intermediary protection for the capital contribution of the individual investor beyond that existing in partnership agreements, but without the rigidity, expense, and legal complexity of incorporating a company. Incorporation usually follows if the venture proves successful. If income is earned beyond that required for the venture's expenses, the surplus income is allocated by the trustee to the participating individuals under the normal taxing provisions and they pay tax at their individual marginal rates. The same venture could have been carried on as a partnership and, if so, surely no tax question would arise. Simply because the participants have elected to use another vehicle, short of incorporation, should there be a tax provision amounting almost to a penalty because

of the form of the organization? Unlike a corporation, the Trust has no form or substance beyond its participants. It is not a separate entity with a mind of its own as is a corporation. It expires when the venture expires.

10.38 The conduit principle inherent in the Trust concept is valid, per se, and the proposal to treat a Trust as a corporation is ill-conceived and unfounded. Nowhere is this more aptly demonstrated than in the case of a Bond Trusteeship or a Stock Escrow Trust. Under a bond issue the trustee is the legal owner of the assets pledged by the borrowing company for the protection of the individual lenders. There is no other legal concept in any system of law which can perform this function of the fiduciary as efficiently. Yet the trust is not an entity separate from the function of that specific fiduciary. The Trust, unlike a corporation, exists for nothing more than that function. Generally speaking, it has no power, duties, obligations or liabilities until default occurs; and then, only to protect the rights of the lenders until the default is cleared or liquidation takes place to satisfy the claims. In similar vein, a Trust for the holding of a stock escrow is non functus except to issue stock deposited with it upon the happening of a certain event. We submit that Trusts of this latter type should be excluded from any tax involvements other than the usual information reporting requirements where applicable.

10.39 The six categories have been outlined in very general terms for the purpose of indicating some of the wide usage applicable to the simple word "Trust". We do not believe all Trusts should necessarily be treated the same for tax purposes, but, at the same time, we would

urge that reform legislation be predicated on the distinctions which do exist and must be recognized. A desire to bring certain types of Trusts into a particular taxing scheme on a basis comparable to that of corporations should not, even by accident, influence the treatment of other types of Trusts - e.g. Testamentary Trusts - with resulting inhibition of use or prejudice to the pure trust concept.

10.40 The White Paper's concern with accumulation is surprising to us. On the basis of our experience the first statement in Section 5.57 is quite misleading. While it is true that accumulated income might bear less tax than if it were distributed, we are certain that in fact this is very rarely true. In the vast majority of cases, the accumulated income will bear significantly more tax than if it were distributed. This is so because distribution is almost always spread through a number of beneficiaries, each being entitled to personal exemptions, whereas the Trust pays tax as a single taxpayer at progressive individual rates, without the benefit of any exemptions at all.

10.41 We are representative of the Trust Industry, but can find no substance for the statement in Section 5.57 to the effect that the number of accumulating Trusts has increased significantly during the past few years. A canvass of the leading Trust Companies and a number of leading legal firms failed to turn up any factual support for this comment. If it is true, it must be taking place in a part of the private sector completely hidden from the Trust Industry and from those of the larger law firms having a Trust practice.

10.42 It happens that because of the operation of law, it is sometimes impossible to determine at a given point in time who are the

proper beneficiaries of a Trust. In such cases, the trustee is bound by law to accumulate until the beneficiaries are determined. Or, the trustee may be placed under a duty to accumulate, as, for instance, if a Trust arises, either by intent or by operation of law, for an infant under the age of 21. The income being earned is taxed as earned in the trustee's hands at the progressive rates applicable to individuals without the benefit of any personal exemptions allowed to individuals. Such income is thus being taxed at higher rates than would normally be the case.

10.43 Accumulation is governed by provincial law and in most of the provinces that law is quite stringent in its application. Because of this, we find it difficult to visualize that the privilege, if it can be called that, of accumulation has any undesirable effect on the tax revenue of this country. In fact, it appears that with all the other restrictive rules which have been developed to govern Trusts, some common law jurisdictions, (e.g. Australia), have completely dropped civil restrictions on accumulations. Particularly in Testamentary Trusts, accumulation is, more often than not, a protective device afforded to the trustee - not to control income allocation for tax purposes, but to give the trustee a tool for the administration of his Trust; to vest in him a discretion so that he can better guide the development of a young beneficiary. We feel that arbitrary tax treatment is unwarranted.

10.44 Probably the two simplest and best examples of legally essential uses of accumulating Trusts are Perpetual Grave Care Trusts and the Trust for an Invalid Wife. In both of these cases the trustees'

expenditures are uneven. It is essential that the trustee be permitted to accumulate to meet future contingencies. Neither is a tax avoidance vehicle. Rather than having an ill effect on the economy of the country, they serve an essential and useful purpose in the general public interest. These examples again point up the necessity of tax measures having a specific relationship to the use and purpose of each particular Trust.

10.45 We would point out that the provisions of the White Paper advocating a capital gains tax on the gross-up principle will create difficulties and inequity when that principle is applied to Testamentary Trusts. In administering a Testamentary Trust, the trustee must keep an even hand between his differing sets of beneficiaries, i.e. - the life tenant and the remainderman. The capital of the Trust Account will have capital gains or losses from time to time in the usual investment operation. As applied to the normal individual, the White Paper proposes to tax capital gains at a rate grossed up on the individual's personal income tax. But, in a Trust, the trustee is dealing with two entirely different people. The life tenant gets the income flow; the remainderman gets the capital. Under the present taxing provisions, the life tenant gets, and pays income tax on, income earned by the Trust; eventually, the remainderman gets the capital subject to whatever gains or losses have affected the capital during the administration of the Trust. Capital gains tax would normally be considered to have to be paid out of the capital of the Trust at the remainderman's ultimate expense. But, if the rate of tax applicable to the gain is to be determined on a gross-up basis, it would seem that the rate applicable to that gain

would have to be determined by some reference to the income earned by the Trust. This is obviously inequitable because there is no relationship between the income flow and the remainderman. We have, in Section 5.02 of this submission, recommended that capital gains tax be segregated and the gross-up principle be abandoned. If this recommendation were adopted, the problem of allocation of tax and the rate applicable to gains in Trusts would disappear. A capital gains in the Trust would be assessed at the capital gain rate applicable thereto and the tax paid by the Trust. We submit that this is equitable as between the life tenant and the remainderman and also equitable with the position of other taxpayers.

10.46 If the provisions of the White Paper for the taxation of Trusts become law, they could have a damaging effect on the lives of many people whose sole livelihood is derived from Trusts established many years ago. The amounts of such Trust settlements were predicated on the tax laws as they existed at the time of settlement or death. Now, because of the intervening death of the settlor or testator, it is too late to supplement the Trust to take care of what may be an added tax burden on the beneficiaries. It might be said that the new tax law would have a retroactive effect on beneficiaries of Trusts which predate the effective date of the legislation inasmuch as they would have no opportunity to assemble resources to offset that burden as the normal taxpayer would have. We submit that such treatment would be discriminatory and inequitable, and we strongly urge that the present provisions of the Income Tax Act be applicable to Trusts which predate any new legislation.

10.47 In view of the nature of this paper and of the comments in the White Paper on Trusts, we have not attempted to indicate and underline specific recommendations in this paper.

INVESTMENT FUND TRUSTS

10A.01 In this part of our brief, we are concerned about a variety of pooled investment fund trusts, operated by trust companies, which appear to be affected by Section 5.56 of the White Paper. The proposals of Section 5.56 lead in turn to those of Sections 4.61 and 4.62, which propose that open-end mutual funds be treated as widely-held corporations and provide special rules concerning them. We feel that we should restrict ourselves in this paper to our own funds. We will briefly describe them and then discuss the proposals contained in the three above mentioned sections of the White Paper as they seem to affect the trust company funds which appear to us to be involved.

10A.02 The descriptions of Trusts in Section 5.56 of the White Paper might be deemed to apply to several kinds of trust company funds, although the section is too inexplicit to identify its effect on any single fund with accuracy. However, the following types of funds issue redeemable units and so might be involved:

1. Investment Funds
2. Pooled Pension Funds
3. Common Trust Funds
4. Pooled Funds for Registered Retirement Savings Plans.

10A.03 Trust companies, for many years, have operated (pooled) investment funds as a means of providing professional investment management services for their clients at a reasonable cost. These investment funds, to our knowledge, have been invariably established as Trusts.

10A.04 Pooled pension funds are operated by trust companies to provide a convenient means of investment for smaller pension funds. They, too, are Trusts and their size is now such that larger pension funds make some use of their units in their investment programmes.

10A.05 Common Trust Funds are authorized under the federal, and several provincial, trust company Acts. In practice their use is limited to Ontario, where their units are employed by estates (normally smaller ones) and trusts, under provincial regulation.

10A.06 Special pooled trust funds are operated by a number of trust companies solely for the use of Registered Retirement Savings Plans. Like the other funds discussed here, redeemable units are employed.

10A.07 We return now to our investment funds, to identify some problem areas created by the proposal to treat trust company pooled funds as corporations. Since fifteen of our member trust companies regularly report to us on about thirty-two investment funds, we will use those to illustrate a point. Of these funds, about fifteen are designed to invest primarily in Canadian stocks; five to invest in foreign, mainly American, stocks; five to invest in Canadian stocks and in interest bearing securities and eleven concentrate on bonds and debentures, with or without mortgages, or invest in mortgages alone. These eleven funds are "income" funds used by persons seeking a combination of security and income.

10A.08 Typically, all of these funds are valued once a month - one is valued twice a month - at which times only may units be purchased or redeemed. Typically, too, the fund units are available only at the

trust company's offices, no special sales force being employed.

10A.09 We must assume from the wording of Section 5.56 of the White Paper that the four types of trust company funds, which we have mentioned above, would be treated as corporations. We make the further assumption that our investment funds would be treated as widely-held corporations and would be taxed in the same manner as incorporated mutual funds. The probable status of the other three types of trust company pooled funds which we have described is a matter of speculation for us.

10A.10 There is no specific reference in the White Paper to the pooled investment funds operated by trust companies. Section 5.56 of the White Paper refers, however, to Trusts which are "in direct competition with widely-held public corporations and have as many beneficiaries (in this case, usually unitholders) as some public corporations have shareholders". The Section continues with a proposal that a Trust be treated for tax purposes as a corporation if it has issued transferable or redeemable units; and, if the unitholders are sufficiently numerous and the marketability of the units so warrants, it be treated as a widely-held corporation. The Section concludes by stating that if such a Trust were a mutual fund, it would be taxed in the same manner as an incorporated mutual fund. This statement has the implication that some funds are and some are not mutual funds. There is nothing, however, to clarify it.

10A.11 Section 4.61 of the White Paper observes that open-end mutual funds, among others, would fall within the proposed definition of a widely-held corporation and that, as a result, mutual fund share-

holders would receive the dividends that flow through the fund subject to the same tax as if they had received those dividends direct. Section 4.62 makes special provision in respect of capital gains realized by a mutual fund.

10A.12 We must take issue at once with the proposition that investment fund trusts of trust companies should be treated for tax purposes as widely-held corporations. It presumably stems from the premise set forth as the last sentence of paragraph 4.61 of the White Paper: "The relationship of the shareholder of the mutual fund to his corporation is much the same as that of shareholders of other public corporations to their corporations", which, by the operation of paragraph 5.56 of the White Paper, serves also as a basis for the treatment of those investment fund trusts which may be deemed to be mutual funds. In fact investment funds operated by trust companies are not analogous to a public corporation: nor are their unitholders comparable with shareholders of a public corporation. The funds and their unitholders have unique characteristics which distinguish them. Examples of such characteristics are:

a) that the only consumers of the service provided by the funds are the unitholders themselves;

b) that the unitholders have the right to claim from the fund, the cash value of their equity interest and have no other rights;

c) that the units of the funds are not listed on stock exchanges (a prime ingredient of the White Paper's proposed definition of a widely-held corporation);

nor are they traded in the same sense as are shares of public corporations;

d) that limited liability is of no value to a fund conforming to the regulations imposed by provincial securities commissions.

10A.13 The only valid analogy of which we know, in respect of an investment fund trust of a trust company, is that of the single large investor who employs investment counsel, for a fee, with full discretion to manage his portfolio. The relationship between such an investor and his investment counsel is the same as that between the unitholder and the trust company. The effect of the White Paper proposal to treat investment fund trusts as widely-held corporations thus imposes a tax burden on the small investor not borne by the large single investor, as will be demonstrated further on in this paper.

10A.14 The Income Tax Act as it exists acknowledges the peculiar status of investment funds, other than those falling within the definition of "investment companies", contained in Section 69(2), by imposing no tax on their income. In the case of "investment companies" a 21% tax is imposed, but it is largely (though not entirely) recoverable by the shareholder through the 20% dividend tax credit.

10A.15 Paragraph 4.32 of the White Paper states that a tax system "should collect the same tax on the investment income of a Canadian individual whether he holds his investments directly or whether he holds them through a personal holding corporation". The same principle is of course, also inherent in paragraph 4.61 with respect to the flow through of dividends on shares held by mutual funds. The White Paper

agrees in paragraph 4.62 that fund share or unitholders should not be put in the position of having to pay tax on capital gains realized by their fund on the sale of shares of public Canadian corporations greater than if they realized their proportion of the gains direct. Taxation of all forms of income from other sources routed through investment funds should surely be governed by the same principle. The failure to apply the principle in the context of gains or income from other sources, which results from treating an investment fund as a widely-held corporation, produces a number of serious anomalies:

10A.16 a) While Canadian taxes paid by the fund in respect of dividends or capital gains from widely-held Canadian corporations would be fully recoverable as a tax credit by taxable Canadian resident participants, Canadian taxes paid on all other forms of income, including interest payments and foreign dividends would be recoverable only to the extent of one-half the tax paid. Consequently participants in a fund invested entirely in interest-bearing bonds and mortgages will retain after tax only about 75% of the net income they would retain if they held the securities directly. The penalty would be so heavy as to obliterate any advantage the participant now has in holding fixed income securities through an investment fund and he would be obliged to cash in that holding and substitute other investment. The effect of the tax, intended or not, would be to prohibit a fund from investing more than a marginal amount of its assets in interest-bearing investments.

10A.17 b) While taxes paid by a fund on realized capital gains described

above would be fully recoverable as a credit by taxable Canadian residents, they would not be recoverable by foreign participants, or by non-taxable Canadian investors such as charitable funds or Retirement Savings Plans by virtue of paragraph 4.60 of the White Paper. Thus, both these classes of participants would be subject to tax liabilities to which they would not be subject if they held the underlying assets of the funds directly. This again is quite inconsistent with the principle inherent in paragraph 4.62 of the White Paper.

10A.18 c) Non-taxable Canadian investors investing directly in foreign securities would, under the White Paper proposals, retain the whole amount of dividends or interest from those securities, less any withholding tax deducted at the source. Should the same investor receive those payments via a fund, however, their net receipts would be reduced to only 50% of the amount of dividends or interest originally received by the fund, the difference being accounted for by non-recoverable Canadian tax paid by the fund. The consequences of the White Paper proposals therefore will be to bar tax-free investors from investing in funds, since the net return available to them in terms of both income and capital gains would be substantially greater if they owned the underlying securities directly. This is particularly unfortunate for individual Retirement Savings Plans for which, tax considerations aside, funds offer many desirable advantages.

10A.19 d) Under the proposals funds would pay tax on realized capital

gains, presumably on a quarterly basis. The tax may be recovered as a tax credit only if the gains on which the tax was paid are actually distributed. Since composition of lists of participants is continually changing, we see great difficulty in ensuring that capital gains and the associated tax credits are properly attributed to the participants to whom they should accrue. The distribution of capital losses would present even more difficult problems. An investor who sells shares of a widely-held corporation at a loss is entitled to deduct one-half the loss from his taxable income. If the loss is suffered by a fund of which he is a shareholder, it should be possible for him to utilize this loss in the same way. The proposals seem to offer no mechanism by which this might be done.

10A.20 Under the present Income Tax Act, provided that income of the Trust is fully distributed, participants are taxed in exactly the same manner as if they held the assets directly. This statement applies to all of the four types of funds described in this paper.

10A.21 This arrangement appears to be completely satisfactory and we are at a loss to know why it should be abandoned and replaced by treating investment funds trusts of trust companies - to which we are limiting our comments in this paper - as corporations, an action which would add to administrative costs, reduce return to investors, introduce serious discriminations and even threaten the existence of some or all of the funds so treated.

10A.22 It might be considered that the conduit principle might be applied by utilizing the proposals set out in paragraph 4.21 of the

White Paper, whereby a closely-held corporation could elect to be taxed as a partnership. The proposals, however, do not provide this choice if a fund were deemed to be a widely-held corporation. Even if this problem did not exist, the option would hardly seem to be practical for the holders of a fund of any significant size. Furthermore, the second requirement of paragraph 4.23 of the White Paper is inconsistent with full recognition of the conduit principle. Participation in an investment fund is the least objectionable form of investment in Canadian enterprises by foreigners, who should be subject to normal withholding tax on income distributed but not, we maintain, to tax on capital gains. In our view the use of the partnership concept is unattractive, partly because it is an artificial device and partly because it raises more difficult technical problems than does the Trust concept.

10A.23 The realizable value of our investment fund trust units is quoted at regular intervals and reflects realized or unrealized capital gains made by the fund. It would appear, therefore, that there is no necessity to tax such gains in the fund itself and to establish the need for a complex system of credits. The gains are automatically reflected in the value of the holding of the unit. It would be quite practical for the trust company to report to the unitholder his capital gain as is now done for other items needed for the income tax reporting of the unitholder.

10A.24 The Committee should give serious consideration to the effect of the proposals for taxing investment fund trusts as corporations, on the supply of mortgage funds. Such Trusts, established as high

yield investment vehicles in the mortgage field, have proved to be very popular with the small investor who has been, until the establishment of such funds, precluded from this field because of the technicalities involved and the initial rather large amounts of capital required. Very large sums have been generated through this concept and applied to the housing industry with wide public approval. Because precise rules have not been set out in the White Paper, we have had to make certain assumptions, but it seems apparent from calculations we have made that implementation of the proposal would result in a serious tax penalty for holders of units of such funds as compared to the direct ownership of fixed income producing securities. We cannot agree that this represents equitable and equal tax treatment. We submit that the conduit principle inherent in the Trust concept is valid, per se, and the analogy of a Trust to a corporation is ill-conceived and unfounded.

10A.25 <u>Recommendations</u>:

a) <u>We recommend that investment fund trusts of trust companies continue to be treated for tax purposes as at present and not be treated as corporations</u>.

b) <u>That consideration be given to a requirement that both income and capital gains be distributed in full at least once a year to effectively place participants in the same position as direct investors</u>.

c) <u>That fund participants be permitted to take advantage of net capital losses suffered by their fund, which could be accomplished by allowing participants to write off the loss</u>

<u>against other taxable gains providing that they reduce the book cost of their fund units by the same amount. Alternatively, the fund might be permitted to carry forward realized losses as an offset against future realized gains.</u>

10A.26 Conclusions

The White Paper proposals as they apply to investment funds appear to be inadequately thought out and are based on a mistaken concept of the real function of such funds. They are not only inconsistent with many of the principles set out in the proposals themselves but they introduce inequities in the treatment of investors of modest means compared to investors with substantial portfolios. The degree of discrimination depends, without any justification, upon the nature of the assets held by the fund. If implemented the proposals would add significantly to the costs of administration borne by participants, with no corresponding fiscal benefit.

10A.27 Elimination of all taxes payable by the fund itself, subject to regular distribution of income and capital gains to participants, would be consistent with the general intent of the proposals without adding unnecessarily to administration costs.

PROPOSED TREATMENT OF NON-RESIDENTS, NON-RESIDENT OWNED INVESTMENT CORPORATIONS AND TRUSTS FOR NON-RESIDENT BENEFICIARIES

11.01 We are concerned with the proposed treatment of non-residents. The contribution to the development of our Canadian economy and standard of living by the non-resident investor has been immense and on a scale probably unequalled elsewhere in the western world. Much of this investment has been of a long term nature and as such has not been withdrawn in the face of short term fluctuations in economic conditions. It was invested here in the expectation of economic growth, political stability and reasonable taxation.

11.02 That our government is concerned by the general extent of foreign ownership of our economy is not surprising. That its response is to propose discriminatory taxation of non-residents to an extent that exceeds the norms of most international treaty arrangements is not only surprising, but appears to be discriminatory and self-destructive.

11.03 The proposals to tax capital gains at income tax rates and to subject substantial holdings of widely-held Canadian corporations to quinquennial capital gains levy are as unwelcome to non-residents as they are to residents. We deal with these proposals elsewhere in this brief.

11.04 We recommend that capital gains on the sale of shares in non-resident owned Canadian closely-held companies and in substantial holdings of Canadian widely-held companies by non-residents be not subject to capital gains tax.

11.05 The taxation of such gains appears to be in contravention of our principal tax treaties, and the willingness of our international trading partners to tolerate such an extension of taxation is questionable.

It is doubtful if it will be enforceable by requiring the underlying Canadian corporation to complete "certificates of compliance" on share transfers as is proposed. We believe that such taxation of shares in the hands of non-residents will make Canada uncompetitive in the world market for development capital . One argument put forward by the White Paper for such taxation is to protect the revenue in the event of integration of corporate and personal taxes. The integration proposal contained in the White Paper is questionable in various details and in any event its protection cannot justify such an internationally radical solution. Other means of avoiding provision of loopholes surely can be devised. It would be interesting to know the government's estimate of revenue from the capital gains taxation of non-residents shareholdings and whether this has been a significant factor in advancing this proposal.

Non-Resident Owned Investment Corporations

11.06 The White Paper states that such corporations are "convenient holding devices for foreign investors in Canadian securities". In our experience they are principally that, having provided a vehicle for foreign investment in Canada and elsewhere for many years. They are a considerable source of capital investment in Canada. In addition, they provide revenue and employment through taxation, commissions and servicing fees.

Proposed Treatment in Relation to Non-Residents

11.07 The reference to non-resident owned investment corporations in the White Paper (6.40) is inexplicit. Clarification by government officials indicates that:

1. they would be subject to tax at a 25% flat rate with no reduction to treaty rates where control is in a treaty country.
2. all capital gains would be taxed at the 25% rate as in 1 above, including gains on sales of widely-held Canadian corporations, regardless of the size of the interest.

11.08 These proposals are in contrast to the proposed treatment of non-residents where:

1. withholding tax would be increased to 25% for residents in non-treaty countries but will remain at a maximum of 15% for residents of treaty countries.
2. capital gains tax would not be payable on gains from the sales of shares of a widely-held Canadian corporation where the non-resident's interest is less than 25%.

11.09 An example of the effect of this different treatment of a typical non-resident owned investment corporation compared to that of the non-resident is attached as Appendix A of this paper. It can be seen that the effect will surely be to tax this "convenient holding device" out of existence.

<u>Beneficiaries of Non-Resident Trusts</u>

11.10 Canadian Trusts are subject to Canadian income tax at personal rates to the extent that such income is not payable to beneficiaries. Income payable to beneficiaries is taxed at the beneficiaries' personal rate. It follows that income distributed to non-resident beneficiaries of Canadian Trusts is at present subject

only to a 15% withholding tax. Dividends received from non-resident owned investment corporations by Trusts that have only non-resident beneficiaries are not subject to further tax in the Trust's hands. Any distribution of such income by the Trust is not subject to withholding tax, it having been taxed in the corporation. This is in accord with the treatment of Trusts as conduits for income tax purposes.

11.11 Recommendations on Non-Resident Owned Investment Corporations

1. That the income of the non-resident owned investment corporation be taxed at a rate equivalent to the withholding tax rate applicable to the country of residence of the non-resident shareholder.
2. That capital gains in a non-resident owned investment corporation be taxable only if such capital gains would have been taxable had they been realized directly by the non-resident shareholder. Furthermore, such capital gains should be taxed at the rate which would have been applicable had the capital gains been realized directly by the non-resident shareholder.
3. In order to place the non-resident shareholder in the same position as if he held the assets directly, we believe that no Canadian tax should be exigible on foreign holdings of non-resident owned investment corporations. Any additional tax liability would be a matter between the non-resident owner and the foreign government concerned.
4. That the provision exempting the income of a non-resident owned investment corporation from further tax, when that income is paid to the foreign shareholder, or to a Trust for the benefit of a non-resident, be maintained.

APPENDIX A

EXAMPLE

Non-Resident Owned Investment Corporation with Net Assets of Approximately $6,000,000. all Invested in Canadian Securities

11.11A 1. Present Treatment

	Dividend Income	$154,000
	Interest Income	2,000
		156,000
Less:	Operating Expense	20,000
		136,000
Less:	Tax (15%)	20,400
	After Tax	115,600
	Capital Gains	271,000
	Total After Tax	$386,600

11.11B 2. Proposed Treatment

	Dividend Income	$154,000
	Interest Income	2,000
		156,000
Less:	Operating Expense	20,000
		136,000
	Capital Gains **	271,000
		407,000
Less:	Tax (25%)	101,750
	After Tax	$305,250

11.11C 3. Proposed Treatment of Non-Resident Investor With Identical Portfolio

		Treaty		Non Treaty
Dividend Income	$154,000			
Tax	(10% *)	$ 15,400	(20%*)	$ 30,800
Interest Income	2,000			
Tax	(15%)	300	(25%)	500
Total Tax		$ 15,700		$ 31,300

* 5% reduction in rate of tax on dividends from corporations having a prescribed degree of Canadian ownership.

** Capital gains from "widely-held" Canadian corporations.

ON GIVING UP CANADIAN RESIDENCE

12.01 The White Paper proposes a deemed realization of capital gains for tax purposes, effective for valuation on the date of leaving Canada. It also proposes a new withholding tax of 25% on pensions paid to Canadians who become non-residents, subject to "lower or higher rates if the circumstances of the recipient warrant". No explanation is given as to how such rates would be determined. The withholding tax proposal would not override Canada's existing tax treaties and it is proposed to reduce the suggested new rates to 15% under new treaties. It may be assumed, for the purpose of this brief, that a Canadian, becoming a non-resident and in receipt of pension payments, would be subject to withholding tax of 15% if his country of residence were one having a tax treaty with Canada and to 25% (or more or less according to the unknown circumstances mentioned in the White Paper) if his country of residence had no such treaty.

12.02 We view these proposals with concern. They suggest a proprietary interest on the part of the government in all Canadians and the deliberate use of tax devices to limit individual mobility and to prevent or hinder departure from Canada.

12.03 The proposed deemed realization of capital gains has been described as a fee for an exit visa. As we have said elsewhere in this brief, a deemed realization of capital gains for tax purposes amounts to a capital levy, not a capital gains tax. To have such a threat hanging over the head of a Canadian who wishes to, or for business or other reasons must, leave the country is to hinder a mobility which Canadians have until now enjoyed. The impact of the

proposal on foreigners coming into Canada for a few years and for Canadians transferred abroad, particularly with the likelihood of return, would be most disturbing.

12.04 The proposed new withholding tax on pensions is explained on the grounds that it is intended to maintain tax exemption for contributions to registered pension plans and for their investment income in the expectation that payments out of the plans will be taxable. The Royal Commission, which made a somewhat similar proposal, but with a recommendation of rates in the 30% to 40% range, said frankly in their report that it was probably necessary to collect such a tax to prevent the emigration of Canadians. It is this aspect which is repugnant to us. Canadians have not had to face such situations heretofore and it would be most unfortunate if such an attitude were to be translated into actual policy in this country. Whatever the logic of the proposal, it must be weighed against the severe consequences on individuals, who should continue to enjoy the rights of mobility. The most common reason for a retired person leaving Canada is a combination of health and climate.

12.05 Neither of the proposals is very likely to affect the young who wish to try their fortunes elsewhere, nor are they likely to affect unduly those of sufficiently ample private means. The main impact will be on those who must rely mainly on pension income after retirement, perhaps supplemented by their own savings.

12.06 <u>We, therefore, recommend that there be no deemed realization of capital gains on leaving Canada and</u>

that no withholding tax be levied against pensions paid to non-residents from registered plans.

All of which is respectfully submitted.

The Trust Companies Association of Canada

C.F. Harrington
President

APPENDIX I

MEMBERS OF THE TRUST COMPANIES ASSOCIATION OF CANADA

TRUST COMPANIES

Administration and Trust Company	Montreal, P.Q.
Canada Permanent Trust Company	Toronto, Ontario
The Canada Trust Company	London, Ontario
The Central Trust Company of Canada	Moncton, N.B.
City Savings and Trust Company	Edmonton, Alberta
Co-operative Trust Company of Canada	Saskatoon, Saskatchewan
Crown Trust Company	Toronto, Ontario
Guaranty Trust Company of Canada	Toronto, Ontario
Hamilton Trust and Savings Company	Hamilton, Ontario
International Trust Company	Toronto, Ontario
The Lambton Trust Company, Ltd.	Sarnia, Ontario
The Lincoln Trust and Savings Company	Niagara Falls, Ontario
The Metropolitan Trust Company	Toronto, Ontario
Montreal City & District Trustees Ltd.	Montreal, P.Q.
Montreal Trust Company	Montreal, P.Q.
National Trust Company, Limited	Toronto, Ontario
Northland Trust Company	Timmins, Ontario
North West Trust Company	Edmonton, Alberta
The Nova Scotia Trust Company	Halifax, N.S.
Rideau Trust Company	Ottawa, Ontario
The Royal Trust Company	Montreal, P.Q.
Savings and Investment Trust Company	Quebec, P.Q.
Société Nationale de Fiducie	Montreal, P.Q.
The Sterling Trusts Corporation	Toronto, Ontario
Trust Général du Canada	Montreal, P.Q.
Victoria and Grey Trust Company	Lindsay, Ontario
Yorkshire Trust Company	Vancouver, B.C.

MORTGAGE LOAN COMPANIES

Canada Permanent Mortgage Corporation	Toronto, Ontario
Crédit Foncier Franco-Canadien	Montreal, P.Q.
The Huron & Erie Mortgage Corporation	London, Ontario
The Eastern Canada Savings and Loan Company	Halifax, N.S.
The Lambton Loan and Investment Company	Sarnia, Ontario
The Nova Scotia Savings and Loan Company	Halifax, N.S.
The Royal Trust Company Mortgage Corporation	Montreal, P.Q.

APPENDIX "B"

BRIEF

TO

HOUSE OF COMMONS STANDING COMMITTEE
ON FINANCE, TRADE AND ECONOMIC AFFAIRS

AND

SENATE STANDING COMMITTEE
ON BANKING, TRADE AND COMMERCE

ON

THE WHITE PAPER ON TAX REFORM

BY

THE TORONTO REAL ESTATE BOARD

MARCH 1970

This submission is made on behalf of The Toronto Real Estate Board. This Board is a member in the Canadian Association of Real Estate Boards and its membership comprises approximately 25% of the total membership of all the Boards in Canada or approximately 6,400 individuals and corporations. The membership of The Toronto Real Estate Board is made up of salesmen, appraisers, real estate brokers, officers of real estate corporations and real estate managers. Each in his different way has an interest in the effects of the White Paper and in some instances the impact of the White Paper differs materially from group to group.

While it is realized that submissions will be made by the Canadian Association of Real Estate Boards which will treat the impact of the White Paper on the real estate industry throughout Canada, certain portions of this brief will inevitably touch upon some of the same areas. However, as far as is possible, this submission is limited to the effect of the White Paper upon the real estate activities in the Toronto area as represented by The Toronto Real Estate Board.

Also insofar as possible, every effort has been made to eliminate petty and inconsequential criticism and to limit the presentation to those areas which the members of TREB feel should be altered and are capable of alteration pursuant to the recommendations herein made.

It may be remarked that the underlying theme of this submission is that the adverse effects of the White Paper on the real estate community will have even more adverse effects upon rental housing. Part of the objective of the arguments put forth herefollowing is to bring to the attention of the Government the plight of rental building and the consequent diminution of available housing and increase in rental costs, should the White Paper bear upon the real estate world with the full and suffocating weight of its present form.

Since a final and more comprehensive submission will be made by the Canadian Association of Real Estate Boards, TREB will limit its points to the following:

Capital Cost Allowance Changes

Taxation of Principal Residences

Rates of Tax

Income Averaging

The Individual Rate Schedule

Top Rate of Tax Should be
Reduced Immediately

Other Items Affecting the Real
Estate Community:

Setoff of Mortgage Interest
in Special Circumstances

Removal of Low Corporate
Tax Rate

White Paper Effects on
Foreign Investments in
Canadian Real Estate

Taxation of Capital Increment of Emigrants

Capital Gains Tax

Expense Accounts

CAPITAL COST ALLOWANCE CHANGES

The capital cost allowance proposals contained in the White Paper as they pertain to real estate can be divided into two categories: those of a general nature referred to in paragraph 5.14, and those of a particular nature, apparently aimed at specific loopholes in the existing system, contained in paragraph 5.17.

With respect to the proposal contained in paragraph 5.14, and noting that the Government intends in due course to invite briefs on the depreciation system and rates of capital cost allowance, our recommendation is that the present system be not altered in any major particular. This recommendation goes to the nature of the system as well as to the rates of capital cost allowance. The only alterations we would recommend will be those necessary to permit the deduction of "nothings", intangible assets and other items in the so-called "gray area" which we understand that the White Paper intends to remedy.

Insofar as the capital cost allowance system itself is concerned, it must be borne in mind that the diminishing balance basis was introduced during the Deputy Ministership of Mr. V. W. Scully, C.A., an eminent chartered accountant, after many years of study and consideration by all concerned. It is submitted that nothing has transpired since the introduction of the system which does other than confirm the wisdom of Mr. Scully's approach and the suitability of the system to the Canadian tax scene. Accordingly, and for these reasons, it is strongly recommended that the system itself not be changed.

There is an implication in paragraph 5.14 that the rates of depreciation are too generous and that the Government believes that "After twenty years of the system it is time for a review. However, depreciation is an important aspect of the tax system and taxpayers should have an opportunity to put forward their views and experience before major changes are considered".

It is interesting to note that while the Carter Commission Report anticipated the White Paper in considering the possibility that the rates of depreciation might be on the generous side, it discarded the notion of altering the rates in the interests of simplicity as well as because of the acceptance of the fact that liberal rates encouraged taxpayers to maintain and up-date buildings, machinery and equipment.

In Volume 4 at page 240, The Carter Report states:

> "Liberal allowances are probably inherent in any simple system, and the present rates therefore appear generally to be satisfactory. As we suggested in chapter 4, a degree of liberality here can be accepted because it would probably assist in economic growth. We therefore recommend that the basic system of capital cost allowances for depreciable assets and the general level of rates remain unchanged."

We feel that we can say nothing further on this point save to wholeheartedly endorse the sentiments above expressed.

The White Paper is not content, however, with dealing with capital cost allowance in general, and paragraph 5.17 contains a three-pronged attack upon a so-called "loophole".

Quite apart from the question as to whether or not a true loophole exists, and if it does exist whether it should be closed, we strongly dispute the wisdom of closing it by the means suggested. The proposals in paragraph 5.17 are more than deterrents and will, in our opinion, have a detrimental effect upon the provision of rental housing facilities and commercial properties.

The "loophole" sought to be closed is indicated in paragraph 5.16 which says that many taxpayers who would otherwise be in quite high tax brackets have become landlords so as to reduce or eliminate their tax burden by claiming the maximum depreciation on their buildings. The objection appears to be that such a taxpayer can never be brought to account through recapture of his depreciation taken since he may continually replenish the class of asset by acquiring another and thus postpone the recapture for a long period of time. If he succeeds in doing so until his death, then his heirs will inherit the depreciable property without recapture at market value. This, the authors of the White Paper evidently consider to be an undesirable thing.

It is submitted that if there is a loophole in the described circumstances, it only exists by virtue of the ability of a decedent to pass on fully depreciated property at a fair market value without recapture to his estate so that his heirs may benefit by starting their capital cost de novo from the increased base. The cure suggested may have more far-reaching and serious effects than the loophole itself.

In the first instance, the provisions in the existing Income Tax Act have operated as an incentive to encourage many small investors to invest in rental properties and have thereby provided needed housing for a great number of Canadians. If these provisions are withdrawn to-day, we foresee a substantial reduction in the amount of private capital committed to rental housing with a resultant significant increase in the level of rents. *It is estimated that private investors own 57% of all the apartment buildings and 30% of all the rental suites in Metropolitan Toronto, with the balance held by developers.

* Source: Teela Market Surveys

The White Paper proposes to eliminate the above so-called abuses by three suggestions. First, that an inheritor of real property should not be entitled to depreciate it at fair market value but should inherit it at the undepreciated capital cost of that property to the deceased.

Secondly, it is suggested that a taxpayer of the kind described should be prohibited from deducting from his other income any loss created by capital cost allowance as a result of holding real property.

Thirdly, it is proposed that a separate depreciation class be created for each rental building costing $50,000.00 or more.

The effect of these proposals will be to make real estate, as a particular item, a most undesirable investment for the long hold. A substantial portion of the private capital available for investment in this area of the economy will be discouraged, particularly from the development of apartment buildings, duplexes and other residential properties of a multiple nature. To the extent that this occurs, rents will increase. Examples of this are provided in attached Exhibit "A".

Since the inception of the Canadian income tax law, individual taxpayers have been assessed in respect of one overall income, being the aggregate of his incomes from all sources reduced by expenses and losses from whatever source. The proposal here considered is the first of a number that may lead to a serious compartmentation of individual incomes. To the extent that this is attempted, it will complicate the assessment procedure, render less realistic the tax impact and the allowances for expenses, as well as blur determination of income. It also runs counter to the general proposal to extend the income concept to income from every source including capital gains. It thus appears to be an anomaly if not an aberration in the proposals, which, quite apart from its economic implications, would seem to be inequitable when measured by the standards of equity sought to be maintained throughout the White Paper. In short, it is felt that any proposal which drives private capital away from the creation of rental premises in the Toronto area is undesirable and at this particular stage of the development of the area extremely damaging.

An example of this is readily available from the experience of this group. It is our belief that apartment projects are now selling in the Toronto area at an unrealistically low rate of return. This is undoubtedly largely due to the capital cost allowance benefits that many private investors now enjoy. In the event that these benefits should be removed, an individual investor under the present proposals needs to obtain a much more competitive rate of return when compared with other types of investment. In order to achieve this from rental property, rents themselves would have to be increased to provide the higher yield unless construction costs and interest rates could be brought down (Exhibit "A"). It is scarcely deserving of comment that the latter is most unlikely to happen in the foreseeable future.

The foregoing illustrations indicate the degree of deviance from the proposition which we first exposed that an individual and a corporation's income is customarily treated as a global amount regardless of the number of sources.

Compartmentation of income for any taxpayer or group of taxpayers leads only to confusion as the English courts have so often aptly said. In addition, the question might well be asked as to why real estate should be treated differently from any other commercial commodity. In all other businesses, income is not compartmented, but is included for taxation as one whole income even if derived from a variety of activities.

In summation, it is our position that the restrictions proposed in paragraph 5.17 and their effect on real estate investing when measured by an investor against the increased advantages of portfolio investment available to him as a result of the integration proposals of the White Paper, will tend to draw equity capital away from real estate and thus further retard the construction of new housing and other needed real estate developments.

The White Paper proposals would appear to be designed to restrict the ability of high income earning individuals to reduce or eliminate their tax liabilities through making real estate investments.

However, it should be pointed out that the Government's proposals could have a much broader effect. The proposals appear to directly affect the growing number of corporations which invest in rental properties, both apartment projects and commercial buildings. Companies in other industries continue to be able to avoid recapture on the sale of a particular asset by crediting the proceeds of sale to the pool of costs which include the company's investment in other assets of the same class. Companies in the real estate industry are being singled out for special treatment.

Some observations in this area are:

While the present capital cost allowance provisions may result in some deferral of tax, they do not result in an ultimate loss of tax revenues, save in the case of the death of individual real estate investors. Likewise, a company which constructs a new apartment building may experience a high vacancy rate in the first year or two following the building's construction. This loss is regarded as a cost of establishing a new source of income, and is incurred in the expectation that it will lead to future profits.

Under the White Paper proposals such a loss would not be deductible from other income. By contrast, a company seeking to develop a new brand name for say a soap product would continue to deduct its early losses. Surely housing warrants as favourable a treatment as soap.

Companies in other industries are not bound by similar restrictions and to this end the implementation of these proposals would introduce discrimination into the tax system. For example, a real estate company would be effectively prohibited from deducting full capital cost allowance on a half-vacant apartment building, while a manufacturing company could continue to deduct full capital cost allowance on a factory building not even in use. This illustration underscores the difficulty of making fine distinctions between losses arising from economic circumstances and those occasioned by an uneven capital cost allowance cure.

We anticipate that the partial integration proposal in respect of dividends received by Canadians from widely-held Canadian companies will create a market prejudice against investment in shares of companies engaged in the real estate development area. This is evident because the method by which the creditable tax is computed requires tax to have been actually paid by the corporation who can then pass credit for the tax to its shareholders. The expanding real estate company can be expected to employ its depreciation to completely absorb its taxable income and thus have no tax payable. Shareholders receiving dividends from such companies would pay full personal rates of tax without abatement for any corporate tax that might otherwise have been paid upon the dividends received.

We anticipate that shareholders of companies in the extractive industries will be similarly affected, since these companies may substantially reduce their current tax liabilities if they conduct an active exploration programme searching for minerals and oil in Canada and if they develop new mining properties.

A similar result will occur in the case of a company which is encouraged by the accelerated depreciation provisions in the Income Tax Regulations to build a large facility in a designated area of slow economic growth in Canada. Reference might also be made to a company incurring large expenditures in research and development.

The effect of the Government's integration proposal seems to be diametrically opposed to existing and proposed incentives in the tax laws designed to encourage a company to make investments which would benefit a particular area in Canada or the entire country. If the company accepts the Government's incentives, it will reduce immediate tax liabilities but will penalize its shareholders' tax position.

It is quite apparent that if this part of the White Paper mechanism is retained, it will create an investment bias away from real estate companies and others suffering from the same disability on the part of shareholders. In the real estate industry this will further diminish the amount of capital available in corporate form for the creation of housing and commercial properties.

TAXATION OF PRINCIPAL RESIDENCES

Paragraph 3.19 of the White Paper indicates that "generally, capital gains on the sale of homes would not be taxed", and that this would be accomplished by providing that when a taxpayer sells his "principal residence" only the profit in excess of the $1,000.00 per year of occupancy would be taxed.

It is the submission of The Toronto Real Estate Board that no gain should be assessed for tax on the disposal of any home in Canada, for a number of reasons. We feel that the Government proposals are unfair and discriminatory and any alternatives which might be devised to achieve the objectives sought in the White Paper would become impracticably complicated.

The inadequacy of the annual exemption of $1,000.00 is illustrated by The Toronto Real Estate Board Multiple Listing Service sales statistics which show average prices of properties sold as follows:

Year	No. of Sales	Dollar Volume	Average Price*	Average Price Houses Only
1961	9,264	$ 151,314,565	$ 16,334	
1962	9,669	$ 161,878,920	$ 16,742	
1963	11,096	$ 183,272,930	$ 16,517	
1964	13,895	$ 241,218,500	$ 17,360	
1965	14,890	$ 281,164,558	$ 18,883	
1966	14,883	$ 326,687,333	$ 21,950	$ 21,360
1967	14,886	$ 367,415,993	$ 24,681	$ 24,078
1968	15,570	$ 430,301,604	$ 27,637	$ 26,726
1969	15,817	$ 473,422,285	$ 29,931	$ 28,945

* Average Price is for all properties sold through Multiple Listing Service, not just houses.

The above figures show an average annual increase in house prices of $1,900.00 per year in the Toronto area in the period 1966 through 1969 $\left(\frac{\underline{28,945 - \$21,360}}{4}\right)$. These statistics are based on sales of approximately 15,000 units per year, and are considered a reliable index of Toronto housing prices. It can be assumed that if the <u>average</u> price increase is nearly $2,000.00 per year, it will take an exemption of substantially more than $2,000.00 to exempt the majority of house sales in the Toronto area from tax.

The proposed exemption of $1,000.00 per year does not take into account the varying rates of increase in consumer price indexes and housing costs in regional cities of Canada. For example, the housing component of the consumer price index for Toronto has increased 20.1% since 1961 while in Montreal it increased 15.0%. Yet the White Paper on Taxation proposes the same flat $1,000.00 per year exemption for principal residences in all cities.

HOUSING COMPONENT
CONSUMER PRICE INDEX
CANADA, (1961=100)

	January 1970	January 1969
St. John's	114.6	112.9
Halifax	116.3	109.6
St. John	114.9	110.3
Montreal	115.0	112.2
Ottawa	117.3	112.1
Toronto	120.1	116.4
Winnipeg	115.0	111.1
Saskatoon, Regina	114.8	111.8
Edmonton, Calgary	117.5	113.2
Vancouver	115.1	111.5

Some comparison with experiences of other jurisdictions may be helpful here. For example, when the United Kingdom recently adopted a capital gains tax, it chose to exempt the gain realized on the sale of a person's principal residence. No monetary or percentage exemption was attempted.

The White Paper contains a rollover provision to defer taxing the capital gains realized on the sale of a home where the proceeds are invested in another home and the change is made in connection with a job transfer.

It is our submission that the rollover privilege should be made available to all sales where the proceeds are invested in another home. When this point is reached, it seems much simpler to exempt home sales altogether. An important reason for not taxing profits arising on transfers from one home to another is to avoid creating an artificial barrier to the normal desire of a family to progress from a small home, when first

starting out with only one or two children and limited capital resources, to a larger home when the size of the family increases and presumably the amount of capital accumulated by the family has also increased. In later years this same family might again move to a smaller home as the children grow up and leave the household. If gains at each move were to be taxed as they would be in the absence of a rollover provision for all transfers, families would become locked into their first home investment with an inefficient allocation of housing resources among Canadians. * Canadian families change their place of residence every four years. This proposal would change a mobile society into a static one.

Perhaps it will be necessary to develop special rules to avoid having the exemption operate as a loophole in the capital gains tax system. One would not expect a person to purchase a large home as a speculative investment in order to achieve a tax free capital gain.

* (As Indicated by Family Allowance Statistics)

	Families Receiving Family Allowance	Number of Accounts Transferred	Percentage
1965	2,755,833	722,672	26.2
1966	2,799,187	747,812	26.7
1967	2,847,770	705,943	24.8
1968	2,901,834	707,112	24.3

The carrying costs in maintaining a large home and the limited market for the sale of such properties would normally make it unattractive for such purpose even with the potential of a tax free gain. However, it is conceivable that a person might purchase a farm on the outskirts of a large metropolitan area and use the farm house as his principal residence in order to avoid tax on a speculative gain in real estate. In such instances, some relatively small area of land and the home, alone, should be exempted from tax.

We have concluded that a different level of exemption would be required for different areas in Canada to exclude the gains on sale of most homes from tax. Perhaps it would also be necessary to adopt a percentage exemption rather than a flat exemption in order to achieve the desired purpose. For example, a house in a small rural area might cost $20,000 whereas its counterpart in a major urban centre could cost $30,000 to $40,000.

Since housing prices tend to rise on a percentage basis, an exemption of $1,000 for the home in the rural area would have to be twice as high for the home in the urban area. An exemption computed as a percentage of the value of the property might achieve the desired result.

A large family would require a large home and therefore will have invested substantially more money in housing than the average Canadian family. It can be argued that such a family can least afford to pay a tax on a capital gain realized on the sale of its dwelling and thus a higher exemption is required for larger homes.

We have considered the various means by which the Government's objective of exempting the gain on the sale of most homes could be achieved through the provision of an exemption and have come to the conclusion that this approach is impractical. It is our recommendation that the Government simply exempt all gains on the sale of a person's residence from taxation.

We foresee a particular hardship arising in the proposal to tax a gain on the sale of a home in the case of a taxpayer who purchased it before the White Paper proposals were implemented and has a higher cost than the value of his home on the day on which the capital gains tax becomes effective. If he should subsequently sell his home for a gain over the valuation day price, he could easily find himself in the position of paying tax on a gain accruing since the system went into effect when in actual fact the price obtained for the sale of his house did not exceed its original cost. This problem might be particularly acute in the Montreal area.

We further submit that the freedom from tax should not be limited to the principal home of any taxpayer, but should extend to the disposition of all bona fide homes.

In addition to the arguments already raised, there are some collateral considerations which should be taken into account and which have not been dealt with in the White Paper itself.

For example, there is the fact that the second home or country cottage trend has resulted in the development and maintenance of many communities which have by that fact become virtually entirely dependent upon their summer residents. Any reduction in popularity or availability of such second establishments because of tax measures could create economic hardship in recreational areas and the less highly developed portions of the hinterland.

Further, it is difficult to advance a logical argument in support of the proposition that an individual who chooses to spend say $30,000 on a principal home may have any gain derived from the sale thereof exempt, while the individual who tends to expend the same amount of money on two homes, say $20,000 on a city dwelling and $10,000 on a country dwelling, would only be entitled to choose one of those homes as his principal residence for purposes of exempting any profit on its disposition. The very concept of a principal residence in Canada today is difficult to justify as a matter of principle. Many persons who maintain

more than one dwelling would find considerable difficulty in regarding one rather than another as a principal establishment. The examples are endless; the principle is clear. In our submission, the simplest and most practical solution is to exempt all homes.

RATES OF TAX

Much is made throughout the White Paper of the fact that tax rates are more equitably conceived and more appropriately distributed over the tax-paying public than heretofore. Much is said of certain burden-saving provisions, such as income averaging and the lowering of the top rate of tax to 50%.

INCOME AVERAGING

The White Paper notes at paragraph 2.53 that the graduated tax system which applies rates of tax to a person's income based solely on the size of a particular year's income will cause taxpayers with irregular incomes to pay significantly higher taxes over a series of years than those whose incomes are more regular.

This problem is particularly acute in the case of persons who sell real estate properties since their commission income can vary substantially from year to year.

We commend the Minister of Finance for recognizing this problem and for proposing a general system of income averaging. However, when we examined closely the the system of averaging proposed in the White Paper we found it to be poorly designed and erratic. It does not achieve the purpose of placing taxpayers with irregular incomes in substantially the same position as taxpayers whose incomes are regular.

The deficiency in the proposed system of averaging is best shown through the use of an example. Let us assume that a taxpayer has taxable income, after claiming personal exemptions and other deductions, of \$3,000 a year in years 1 to 4 and taxable income of \$8,000 in year 5. The taxpayer's average taxable income for the five year period is \$4,000. The following tax results using the combined

federal and 28% provincial tax rate schedule in Table 2, page 25 of the White Paper:

Tax without averaging		
Tax on \$3,000 - (\$742 x 4 years)		\$2,968
Tax on \$8,000 in year 5		\$2,355
		\$5,323
Tax using proposed system of averaging		
Tax on \$3,000 - years 1 to 4		\$2,968
Tax on \$8,000 in year 5 -		
Tax on \$4,000 (threshold level - 133 1/3% of \$3,000)	\$1,024	
Tax on \$4,000 (5 x \$800 x 30.72)	\$1,229	\$2,253
		\$5,221
Tax if \$4,000 received in each of 5 years		
Tax on \$4,000 - \$1,024 x 5		\$5,120

In the above example the difference in tax resulting because the aggregate taxable income of \$20,000 realized over a five year period was received in an uneven basis rather than at a uniform \$4,000 a year is \$203 (\$5,323 - \$5,120). Income averaging as proposed by the White Paper reduced this difference to \$101 (\$5,221 - \$5,120) thus achieving a saving of only 50% of the desired results of true averaging.

We have worked out other examples which show the proposed income averaging system to be less favourable than in the above case; we have also noted situations where it is more favourable but in no case does the proposed system produce as low a tax as would have resulted if the taxpayer had received his income in even amounts over the five year period.

The averaging system proposed by the Minister of Finance requires first that the taxpayer's income in a particular year be more than 133 1/3% greater than the average for the previous four years. No relief is given where income declines sharply. The Report of the Royal Commission on Taxation stated at page 269 of Volume 3 that there is as much, if not more, justification for giving relief when income declines sharply as when it rises sharply.

In addition to the limitation placed on averaging, namely that the income of the year be greater by one-third than the average income of the previous four years, the White Paper

proposes that only the amount above the so-called "threshold level" be eligible for averaging and furthermore that this amount be subject to tax at rates applying above this threshold level. In our example average taxable income in the first four years was $3,000 in which case the threshold level amounted to $4,000 (133 1/3% of $3,000). Of the $8,000 of taxable income in year five only $4,000 (being $8,000 less $4,000) was subject to averaging. This $4,000 was taxed at the marginal rates applying in excess of the $4,000 threshold level. If the taxpayer had received the same total taxable income for the five year period in even amounts ($4,000 a year) he would never have reached the rate applying above $4,000.

We recognize the need to limit averaging to incomes that fluctuate significantly but suggest that, once this condition is met, income be truly averaged and not subject to tax at rates applying at a level 133 1/3% above the average income as proposed in the White Paper. Under the White Paper proposal if average taxable income in the first four years is

$18,000 the "threshold level" becomes $24,000 and any income subject to averaging in the fifth year produces no tax saving since it is all taxed at the top rate reached at $24,000. (It is not clear if any benefit will be available from general averaging in the early years of the system when the top rate is higher than 51.2%).

We would suggest that the government adopt true averaging along the lines proposed by the Royal Commission on Taxation which the White Paper notes at paragraph 2.54 is similar to that now available for farmers which system the White Paper proposes to continue. We feel that other taxpayers in this country have incomes which fluctuate not unlike that of farmers and should be entitled to the same relief.

THE INDIVIDUAL RATE SCHEDULE

The White Paper proposes a rate structure which the government estimates will yield it $630 million more in the fifth year of operation than if the present system were continued.

The rate schedule results in significantly higher revenues to the government in later years due to the delayed nature of certain features of the system, principally the taxation of capital gains and the removal of the low rate of tax on the first $35,000 of corporate income. The government's revenue forecasts for the fifth year do not take into consideration the additional revenue which will accrue to the federal government once its proposals for the taxation of the natural resource industries become fully effective. Ontario has estimated that the tax increase could be twice as large as the federal estimate of $630 million and certainly in excess of $1 billion when the proposed reform plan is fully mature.

We have no way of determining which estimate is the more accurate but can conclude that both estimates point out that the tax reform proposals will generate substantial additional revenue as the system matures.

The Minister of Finance of Canada has stated that his government is not proposing to increase taxes with its tax reform proposals. He has stated that the new system is designed to produce approximately the same revenue in the first year of operation as the present system. While he

recognizes that this sytem will produce greater revenue in later years, the Minister has stated that it would be up to future governments to review estimated revenue forecasts and adjust the rate schedule at that time.

We might agree that more accurate revenue forecasts could be made after the first year or two in the new system but still strongly recommend that when the White Paper proposals are enacted provision be made at that time for schedules of individual income tax rates to apply in later years which would offset the present forecasted increase in government revenue. Future governments would then be required to lay before Parliament legislation to increase these rate schedules if they desire to increase government revenue. It is important that future governments be faced with the necessity of actually having to come before Parliament and the people in order to obtain additional government revenue of the magnitude set out in the White Paper. Under the White Paper proposals future governments could achieve substantial increases in revenue without altering the tax laws at all. It is our belief that our members might be more willing to accept a tax reform package

if they knew that the proposals were not designed to increase government revenues in later years of the system but instead that Parliament would continue to control changes in the level of government revenues in future years, by adjusting tax rates to revenue needs.

TOP RATE OF TAX SHOULD BE REDUCED IMMEDIATELY

The White Paper suggests that it is undesirable to tax income at a rate in excess of 50% but provides no adequate support for the proposed delay of five years in reducing the top rate of personal income tax to this level. Since capital gains are to be taxed immediately at the full marginal rates, and since during the five years scale down these rates may well exceed 50%, it is recommended that the top rate of 50% be immediately introduced as the top rate from the introduction of the legislation. This suggestion is made notwithstanding the fact that it is understood that the White Paper indicates in Table 15 at page 95 that such a reduction would cost $40,000,000. Any other course of action would be inconsistent with the Government's professions of equity and the highly touted overall reduction in tax burden so prevalent throughout the White Paper.

OTHER ITEMS AFFECTING THE REAL ESTATE COMMUNITY

In addition to the items already dealt with, there are a number of provisions throughout the White Paper which have an impact upon the real estate community which are best dealt with because of their heterogenous nature under one heading hereafter.

Setoff of Mortgage Interest in Special Circumstances

Where a taxpayer sells his home and purchases another, he may often be in the position of having to accept a second mortgage on the sale of his first home and to borrow money on the security of a mortgage to purchase his second home. The Income Tax Act does not permit the taxpayer to offset interest paid to acquire a home to live in, as being a personal expense, against the income received from the mortgage given on the sale of the old home. This has been upheld in the Tax Appeal Board in the case of Hopkins v. M.N.R., (1962) 30 Tax A.B.C. 269. The concept of setoff is a well-recognized legal notion in the law of Canada. Any proposal which takes account of equity as does the White Paper should take account of the principle and permit it to operate under the taxing laws.

We regard the absence of mortgage interest setoff as inequitable, the more particularly since it is becoming increasingly acute in recent years with the substantial increase in mortgage interest rates. More home owners are forced to take back second mortgages in order to sell their homes. Purchasers seek to continue the favourable first mortgage interest rate but are not inclined to pay the very high second mortgage interest rate that would be demanded by a commercial lender. Thus he forces the vendor to take back a second mortgage at approxiamtely the current first mortgage rate in order to sell the house. The vendor, however, is then forced to take the larger mortgage on the purchase of his new home.

It is recommended that in these circumstances the taxpayer be permitted to deduct mortgage interest paid on the purchase of his new home to the extent of the interest received from the mortgage taken back on the sale of the first house.

Removal of Low Corporate Tax Rate

In the Toronto area the preponderance of real estate brokers has adopted the corporate form. Few of these can generate capital save through accumulated earnings and the utilization of the current write-offs allowed under the present system, one of which is the low rate of tax on the first $35,000 of income.

To eliminate this form of capital building assistance to the small or quasi service corporations will place them at a competitive disadvantage with companies whose access to the capital markets is more effective by virtue of having assets available for security and a proven earnings picture.

Mr. Benson has indicated that some relief may be given to small business as such, but it is not clear whether such amendment, if it comes, would extend to the small incorporated operations so frequently seen in TREB.

Under the Real Estate and Business Brokers Act of Ontario the active brokers in the business are required to own 51% of their companies. This restriction would seem to mitigate against any broker becoming a widely held corporation.

White Paper Effects on Foreign Investment in Canadian Real Estate

The larger metropolitan areas of Canada have benefitted during the last twenty years from substantial infusions of foreign capital which has been invested in the development of large commercial and industrial real estate complexes. In addition, a substantial amount of foreign capital has gone into the provision of apartment dwellings and low-cost housing. Non-residents have invested in Canadian real estate for a number of reasons among which the principal ones appear to be, first, a steady growth potential in a developing country with a capital gain to be reaped on disposition. Secondly, the yields until the last few years have been quite satisfactory and competitive with less risk than those obtainable in Europe and elsewhere. Thirdly, the desire of overseas investors to obtain a hedge against inflation by buying real property and the fact that Canada's once growing future portended a safe and increasingly valuable holding. Fourthly, the withholding tax on rentals and interest remitted abroad have been competitive and it has not required the taxpayer to live in a Treaty jurisdiction to obtain the 15% withholding tax rate in Canada. This rate compares

extremely favourably with the American withholding tax rate of 30% and other higher rates of withholding tax imposed by other countries to residents of non-treaty jurisdictions.

If the White Paper proposals dealing with non-residents investing in Canada are to be maintained, these advantages will disappear or be substantially reduced in their attractiveness. In the result, we may expect to see and indeed are presently seeing a substantial liquidation by non-residents of their Canadian real estate holdings. While this might appear to provide Canadians with short-term good investment opportunities, it must be remembered that every sale signals a substantial withdrawal of capital from this sector of the investment market and its future will be reduced in desirability and expectations of growth. Canada can well look to a future in which it will not enjoy a continuation of the large commercial and residential complexes which it has seen built in past years by foreign money. To give one example only, the City of Montreal in the Dorchester Boulevard area, including the Place Ville Marie complex, would not have come into existence had it not been for the imagination, credit facilities and drive of Mr. Zeckendorf. The same

might be said for the Guiness interests in Vancouver and their creation of the Pacific Properties concept on the north shore. Many development projects, involving the investment of hundreds of millions of dollars in foreign capital, are under way or in the planning stages in Metropolitan Toronto. Among them are the Four Seasons Sheraton Hotel which is being created by Four Seasons Hotels Limited. International Telephone & Telegraph and Sheraton Corporation of America; and the $50 million complex of Fidinam (Ontario) Ltd., a subsidiary of a Swiss organization drawing most equity funds from Europe.

Nowhere is the difficulty more dramatically emphasized than in the case of the proposed taxation of real estate unit trusts where the units are owned by non-residents of Canada. Under the present law holders of these units who do not reside in Canada receive their investment revenue at a cost of only the 15% withholding tax. The trust itself pays no tax in Canada on any monies which it pays or credits to the unit holders. Such taxation was intended to compare favourably with the position of a non-resident who owned a direct interest in Canadian real estate. If he were holding real estate in his own name in Canada and could obtain a carefree lease, he would suffer only a tax of 15% at the source on the money remitted to him.

Under the new proposals, however, which indicate that a unit trust will be taxed on the same footing as a widely-held Canadian company, the trust would suffer 50% tax on the monies it received and would then have to withhold 15% or 25% depending upon whether the recipient of the ultimate income were a resident of a treaty country or not. As a result of this proposal, the rate of income tax which the holder of a unit in a Canadian real estate trust resident abroad would pay could increase from his present rate of 15% tax to 62 1/2% under the White Paper.

Taxation of Capital Increment of Emigrants

The proposal to tax the accrued capital gains of persons emigrating from Canada will also act as a substantial barrier to non-residents coming to Canada especially where the transfer is for a limited period of time. An executive asked to transfer to Canada for a period of several years could, on leaving, find himself paying large amounts of tax not otherwise exigible solely because of his transfer. On coming to Canada, he would be deemed to have acquired all property owned at that time at its fair market value. When he left Canada he would be subject to capital gains tax at full rates on

the deemed realization of the increase in value of his world assets during the period that he was in Canada. At a later date, when his gains were actually realized he would be subject to capital gains tax in his home country with no assurance that he would obtain credit in that country for Canadian tax previously paid on the deemed realization. In the circumstances, we would expect many non-residents to refuse a transfer to Canada for a short period of time when faced with deemed realization on leaving the country.

Canada can gain much from the skills of foreign persons even if they are in Canada for only a short period of time. The government has noted that continued foreign investment in this country is necessary to maintain our standard of living. Foreign investment will not readily flow into Canada if our country discriminates against foreign personnel who come to Canada to manage these investments.

Capital Gains Tax

The Toronto Real Estate Board is not opposed to a capital gains tax but does disagree with the Government's proposal to tax capital gains realized on other than the shares

of widely-held Canadian corporations, at full rates of income tax. The Toronto Real Estate Board might agree that assets held for a short period of time could be taxed as ordinary income but that a gain realized on an asset held for say, 1 to 2 years, should be taxed at a lower rate than that which applies to ordinary income. A lower rate would recognize that some portion of the gain reflects inflation; also the gain may have built up over a number of years and it is undesirable to tax such a gain in one year at personal rates which are steeply graduated. The White Paper averaging proposals are of little assistance in this area. Insofar as inflation is concerned, it is particularly dangerous to ignore it, even as a matter of principle, when proposing to tax capital gains. If one were to imagine inflation at the rate of 100% per annum, then a 50% capital gains tax would soon cease to bear on anything but the inflation factor and would quickly have to be repealed.

Perhaps the strongest argument for taxing capital gains at a lower rate is that a number of other countries follow this practice and it cannot be in Canada's best interest to move overnight from a position where

capital gains are not taxed to one of the highest levels of taxation in the world. The disruptive effect that it will have on our economy cannot be overlooked.

The present level of income tax has developed over a period of 50 years. One can easily imagine the disastrous effect on any economy if the proposed rate schedule in Table 2 of the White Paper was imposed at a time when there were no personal income taxes.

The federal government recently made substantial amendments to the Estate Tax Act. Transfers between spouses were exempted from tax but the rates of tax on transfers to children were made much more steeply progressive reaching a maximum of 50% on a taxable estate of $300,000. Previous to that time, the marginal rate which applied at the $300,000 level was 30% and the rate of 50% was not reached until a level of $1,550,000. The White Paper is now proposing to tax capital gains as ordinary income with a rate of income tax reaching 51% at a taxable income of $24,000.

After the capital gains tax has been in operation for a number of years the estates of successful Canadians will

have been substantially subjected to taxation at rates of income tax at or near 50%. To further subject such estates to a second tax, the estate tax, at 50% will mean a combined rate of tax of 75% levied on the accumulation of private capital.

The Toronto Real Estate Board recommends that the Estate Tax Act be abolished or at least that the estate tax rate schedule be made far less onerous. Otherwise, the combined effect of these two taxes can be expected to substantially reduce the amount of private capital in Canada and to also have an adverse effect on the willingness of Canadians to accumulate capital in the first place. These taxes will discourage people with wealth or high income earning capacity from immigrating to Canada and may encourage Canadians in similar circumstances to leave this country. In fact, the White Paper proposals on top of the recent estate tax amendments may well encourage more of our wealthier Canadians to leave Canada before or shortly after valuation day in order to avoid the impact of these two taxes. Further increases in the value of these peoples' assets (much of which can be expected due to inflation) will be taxed at 50% and

an estate tax of 50% will be levied on all of their assets at death.

It might be pointed out that Canada collects somewhat in excess of $200 million in federal estate tax and provincial succession duties. Approximately $50 million or one-quarter of this amount is retained by the federal government and the balance is received by the provinces. Two provinces, Alberta and Saskatchewan, have already enacted legislation to rebate their share of the estate tax to the estates of persons who were domiciled within their jurisdictions at death. Last year, the Treasurer and Minister of Economics of Ontario when introducing his government's tax reform proposals indicated that Ontario would introduce a tax on capital gains. The Minister then went on to say that as the capital gains tax becomes fully effective in the years ahead, the need for taxation of estates will diminish and such tax should be gradually eliminated. At the recent Federal-Provincial Conference of Finance Ministers held in Quebec City, the Finance Minister of Nova Scotia and the Treasurer of Ontario criticized the federal government for wanting to tax capital gains at full personal tax rates without a corresponding reduction in estate tax rates.

Expense Accounts

Since the decision of the Exchequer Court of Canada in Royal Trust Company v M.N.R., (1957) C.T.C. 32, it has been accepted that expenses paid by a business to enable its employees to join clubs and entertain customers therein were deductible. This principle has been extended until all expenses which are reasonable in character and in an amount having relationship to the type of business the taxpayer is in and the income which he produces have been allowed. Obviously those most easily allowed have been those which are paid by an employer to an employee since it was assumed that the payor would check carefully before he disbursed his own money for the benefit of his employee. Under this heading have come golf, curling, sailing, flying, fishing clubs and other sporting endeavours, and particularly the attendance at conventions. The Government in paragraph 2.11 of the White Paper proposes to set more rigorous limits to check "expense account living". "The costs of attending conventions and belonging to clubs will no longer be permitted as a charge in determining business income. The cost of yachts, hunting and fishing lodges or camps, amounts spent for

tickets for games and performances, and costs of entertainment also would be excluded. Owners or employees of a business having a car or aircraft available to them for their personal use, including travel to and from home, will have to pay the business a minimum standby charge or have a corresponding amount added to their personal income for tax purposes."

Historically, the Royal Trust case established a principle which we submit should be respected by the White Paper since it is fundamental to the determination of all income. This principal was enunciated by the then President of the Exchequer Court, Thorson, P., at page 42 in (1957) C.T.C., where he said:

> "...it may be stated categorically that... the first matter to be determined in deciding whether or not they are expenses outside the prohibition of Section 12(1)(a) of the Act is whether it was made or incurred by the taxpayer in accordance with the ordinary principles of commercial trading or well accepted principles of business practice."

He goes on to say that only if an expense was not so laid out can it be disallowed out of hand, but that if it was incurred within the principles and practices of business and accounting, it must be allowed unless there is some express prohibition in the law.

There is no question, and it need not be argued here, that expenses of the kind which the Government seeks now to bar, except to the extent that they constitute abuses, must be allowed as deductions once it can be established that they were laid out for the purpose of earning the income from the trade or business in which they were incurred. Thus for the Government now to propose the prohibition to which the Exchequer Court President referred in his judgment is to go against the fundamental principles of business and accounting practice which the Government professes to revere as a norm in the White Paper. The real estate salesman presents an apt example of the practical application of the principles above stated. Real estate is essentially a selling business and entertainment expenses are frequently an essential element in producing an income by means of making or keeping contacts by ascertaining the needs, desires and standards of living of customers and by establishing surroundings conducive to the creation of mutual trust and satisfactory negotiations. There is already in the income tax administrative system ample provision for safeguarding against frivolous and excessive use of this type of expenditure.

By the same token, the larger real estate company, even one involved in the supervision or creation of rental properties, requires that some money be spent on building good will. Its ability to reach its customers or potential customers on a personal basis is as essential to it as advertising is to an automobile manufacturer or an airline.

Perhaps one of the most objectionable items in this proposal is the one to eliminate the expenses of attending conventions. This proposal can only be regarded as a freudian slip with puritanical overtones. To argue that the expenses of attending conventions, bona fide in their character and not undue as to their quantum, should be disallowed while encouraging continuing education at all levels in different classes of business activity is a contradiction in terms. Over the years organized real estate at the provincial as well as at the national level has endeavoured to keep abreast of economic and financial conditions as well as to educate the public in the fields of housing and urban development.

In order to achieve a position of leadership and to be able to give sound and practical advice and assistance to the customer, the real estate salesman must himself keep ahead of the public knowledge in a large number of areas. To this end, various seminars and conventions have been and are organized from time to time which include educational courses and which are convened at different locations within and without Canada. Over the years such gatherings have endeavoured to improve a salesman's understanding of and competence in the fields of financing, land costs and utilization, construction costs and techniques, social housing and special programmes, urban development, administrative structures of government and local and provincial research into the future of the housing industry. Many salesmen invest considerably more money than they charge against their commission income to enable themselves, and their wives where required, to attend conventions and educational courses each year. They do so because they feel that it benefits them and improves their ability to produce and thus earn revenue for themselves.

EXHIBIT "A"

APARTMENT BUILDING SALE:	Instr.No.76315 EM dated May 10, 1967
	W. Thedelron Handelman to: E. R. Morgis et ux
Consideration:	$965,000 with $171,272.95 cash
Location:	485 Huron Street, east side about 585 feet north of Bloor Street, in the City of Toronto
Lot Area:	114' x 193' 9" average
Improvements:	70 unit apartment building, comprising 21 bachelors, 33 - 1 bedroom, 15 - 2 bedroom and 1 - 3 bedroom unit
Income & Expenses:	Total income = $141,000, expenses including 4% allowance for management = $58,065, therefore net income before depreciation and mortgage debt charges is as follows: Income = $141,000 Expenses = $ 58,065 Balance = $ 82,935
Overall Rate:	Before depreciation (recapture) equals $\frac{\$82,935}{\$965,000}$ = 8.59%

A 10% overall return would require the following rental increase:

$965,000 x 10%	=	$ 96,500
+ expenses	=	$ 58,065
Total	=	$154,565

Increased rent = $\frac{\$154,565}{\$141,000}$ = 109.6

say increase of 10%

Note: Actual rent increase would have to be slightly higher to allow for 4% management fee on increase

EXHIBIT "A"

APARTMENT BUILDING SALE:	Not yet registered - date October 17, 1968
	Vendor: Bolivar Limited
Consideration:	\$730,000 with \$180,000 cash
Location:	1002 Lawrence Avenue East, near Don Mills Shopping Centre
Lot size:	?
Improvements:	65 suite apartment building 35 - 1 bedroom and 30 - 2 bedroom units
Income & Expenses:	Income after vacancy allowance = \$102,244 - expenses including 4% management allowance = \$46,051 therefore net income before mortgage debt charges and depreciation equals:

Effective Gross Income	= \$102,224
Expenses	= \$ 46,041
Balance	= \$ 56,183

Overall Rate: Before depreciation (recapture) equals $\frac{\$\ 56,183}{\$730,000} = 7.7\%$

A 10% overall return would require the following rental increase:

\$730,000 x 10%	= \$ 73,000
+ expenses	= \$ 46,041
Total	= \$119,041

$\frac{\text{Increased rent}}{\text{Actual}} = \frac{\$119,041}{\$102,224} = 116.4 = 16.4$ increase

Note - Actual rent increase would have to be slightly higher to allow for 4% management fee on increase

APPENDIX "C"

Submission

to the

The Standing Committee of the Senate

on

Banking, Trade and Commerce

May 15, 1970

Canadian Institute
of
Public Real Estate Companies

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The Institute

The Industry

Submission

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THE INSTITUTE

The Canadian Institute of Public Real Estate Companies was incorporated in March of 1970. The objectives of the Institute are as follows:

(a) the preparation of statistical data and research in relation to residential, commercial and industrial development;

(b) to achieve common industry standards of financial reporting and conduct; and,

(c) to represent the public real estate companies with respect to matters of common concern.

The Institute is a national organization and each of its general members is listed on at least one Canadian stock exchange. As of May 15, 1970, the following companies were members of The Institute:

GENERAL MEMBERS

Bramalea Consolidated Developments Limited
Cadillac Development Corporation Limited
Cambridge Leaseholds Limited

Campeau Corporation Limited

Canadian Equity and Development Company Limited

Canadian Interurban Properties Ltd.

Consolidated Building Corporation Limited

Cummings Properties Limited

Dawson Developments Limited

Halifax Developments Limited

The Great West International Equities Limited

Markborough Properties Ltd.

M.E.P.C. Canadian Properties Limited

S.B. McLaughlin Associates Limited

O.S.F. Industries Ltd.

Trizec Corporation Ltd.

Victoria Wood Development Corp. Ltd.

Wall and Redekop Corporation Ltd.

ASSOCIATE MEMBERS:

Marathon Realty Company Limited

Paragon Properties Limited

This brief represents the Institute's first participation in public discussion and it is highly appreciative of the fact that the Government of Canada has chosen to consider tax reform in this open and participatory manner.

THE INDUSTRY

The major problem of the real estate industry today is the lack of available capital and its extremely high cost. In its 1969 Annual Report, the Economic Council of Canada estimated that by 1975, expenditures in the residential housing sector alone should exceed $5 billion or 4.4% of Canada's gross national product. Industrial and commercial construction will add greatly to this total. As such, the Industry's primary requirement is for sufficient capital in order to satisfy the growing demand for residential, commercial and industrial accommodation.

The attraction of capital to the Industry has been traditionally hampered by small unit size (even today, no one company builds as much as one per cent of the residential accommodation in Canada), fragmentation, intense competition and the periodic cycles of federal government monetary and fiscal policy which have tended to expand or contract the capital funds available for development purposes for economic reasons seldom related to actual national demand. The growth in the number and size of public real estate companies is a response to some of these problems as well as an effort to obtain additional sources of equity capital. Without an adequate supply of equity capital, the supply of mortgage capital will be chronically unsatisfactory, particularly at

a time of high interest rates dictated by international conditions which are unlikely to alter in the short term.

The increase in the cost of money has already had a significant effect upon the cost of houses and rental accommodation for Canadians everywhere. Mortgage rates have increased by more than three per cent in three years. In the residential field alone, the increased cost of money per unit of accommodation has in this interval added more to the price per unit than the sum total of increases in wages, building materials and municipal taxes.

In addition to the shortage of capital, the low return on investment prevalent in the industry today has made it difficult to attract additional investment. Indeed, the rate of return on residential housing is now less than the interest rate on mortgages. Any further decline in the rate of return may result in the diversion of existing capital to industries with higher investment yields. This will obviously reduce the ability of public real estate companies to meet the challenges of a developing nation.

SUBMISSION

The Institute submits that implementation of the White Paper would make it even more difficult than at present for the private sector to satisfy the need for capital in the real estate industry.

A. CAPITAL COST ALLOWANCES:

1. Section 5.17 of the White Paper proposes that a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance, interest charges or property taxes. This section also proposes that a separate depreciation class be created for each building that costs $50,000 or more. Public real estate companies would be profoundly affected by these proposals. The Institute strongly opposes them for the following reasons:

(a) They discriminate against the real estate industry as opposed to all other types of business. If legislation is enacted on this basis, the normal rule that a taxpayer must pay tax on his net loss or gain in each year from all sources will be abolished as will the pooling concept of capital cost allowances.

(b) The actual economic depreciation of each rental property does not occur at the same rate. For various reasons, some properties depreciate in value while others may appreciate either in a real or inflationary sense. If only buildings that have diminished in value can be sold without adverse tax consequences, there will be a tendency for owners of existing properties to hold them and as a result, development may be slowed.

(c) The general pattern in the construction and property development fields is that losses are incurred until buildings are fully leased. Thereafter, they are usually held as an investment for some period of time until sold and the proceeds reinvested in new construction or development. The proposals contained in Section 5.17 favour those companies that are not expanding and will have the effect of curtailing the activities of corporations that in the past have initiated much of the new residential and commercial construction in Canada.

Investment in real estate is generally of a long term nature and any subsequent change in taxation will substantially

affect the economic feasibility of a project. The proposals contained in Section 5.17 if implemented should only apply to new acquisitions.

2. Section 5.14 of the White Paper suggests that the current capital cost allowance rates might be changed at some future time. It is the Institute's view that the existing rates applicable to depreciable property in the real estate industry are realistic and that they provide a very necessary source of capital. As discussed below, implementation of certain other proposals in the White Paper will reduce the capital available for property development with the result that public real estate companies will be unable to meet the demand for accommodation. Therefore, it is recommended that the existing rates of capital cost allowance should not be reduced. When the system of capital cost allowances is considered in greater detail by the government, the Institute will submit a further brief on that specific subject.

B. CAPITAL GAINS AND INTEGRATION:

The Institute has serious misgivings about the proposals for taxing capital gains and integrating the taxation of corporations and shareholders.

1. The effect on shareholders of real estate and property

companies will undoubtedly be prejudicial. Since many of these companies are entitled to deduct substantial amounts of capital cost allowance, most distributions to shareholders will be made out of non-creditable tax and will, therefore, be taxable to the shareholders at full marginal rates.

According to studies prepared for the Royal Commission on Taxation, under existing legislation, approximately 60% of the pre-tax yield on stocks arises in the form of untaxed capital gains and 40% in the form of taxed dividends. The combined effect of imposing a capital gains tax and integrating corporate and shareholder income would, under the above assumptions, reduce the after-tax yield of an investor with a 50% marginal tax rate by approximately 15% on stocks of widely-held Canadian corporations. In the case of shareholders of public real estate companies, since distributions will be made out of non-creditable tax, their effective after-tax yield will be reduced by approximately 27% as compared to the present system and their yield will be approximately 12% less than for other widely-held Canadian companies.

Based on the Royal Commission's estimate that approximately 60% of the pre-tax yield on stocks arises in the form of a capital gain and 40% in the form of dividends, the following table compares the tax treatment of $100.00 of

shareholder revenue under the present system and that proposed by the White Paper:

	PRESENT SYSTEM	WHITE PAPER	
		Widely-held Canadian Companies (with creditable tax)	Public Real Estate Companies
Total Revenue	$100.00	$100.00	$100.00
Dividend	40.00	40.00	40.00
Capital Gain	60.00	60.00	60.00
Tax on Dividend (assuming a 50% rate)	12.00 *	10.00	20.00
Tax on Capital Gain (assuming a 50% rate)	0	15.00	15.00
Net Return (Total Revenue minus taxes on dividend and capital gain)	88.00	75.00	65.00
% decrease		15%	27%

* after deducting the 20% dividend tax credit

As a result, equity financing for real estate companies will become more difficult because of the bias in favour of other Canadian companies with creditable tax. As a corollary, the shares of companies speculating in vacant land will be made more attractive than those of companies actually providing

residential, industrial and commercial accommodation. It is submitted that the problem could be avoided if distributions out of non-creditable tax could be treated as either a capital gain or credited to the cost base of the shareholder. The latter alternative is favoured.

2. The Institute has found it difficult to estimate the combined effect of integration and the capital gains tax. If implementation of these proposals should result in a heavier burden of tax than would be exigible under the laws of our major trading partners, it is opposed. Furthermore, since the effects may be uncertain, it is suggested that any proposed legislation should be based on a system which is already in existence and has been found to be workable. In this regard, we would recommend adopting the United States' precedent and a maximum rate on capital gains of 25%.

3. Section 4.27 of the White Paper states that corporations must distribute their earnings as dividends within two and one-half years or creditable tax will be forfeited. The Institute fails to comprehend the necessity for this rule. Firstly, it has been argued that the two and one-half year rule is necessary in order to limit the amount of outstanding claims against the Government. We submit that this argument is more than offset by the fact that the Government has

enjoyed the interest-free use of the taxpayers' money during the interim period. Secondly, reference is made in the White Paper to the fact that taxpayers who cannot make use of the creditable tax might be tempted to transfer their shares to individuals who could take advantage of it. The proposal to tax capital gains renders this reason of doubtful validity since the vendor probably would realize a capital gain of not less than the retained earnings and, therefore, be subject to the same tax as if a dividend distribution had occurred. Thirdly, the dividend policy of public companies is largely dependent upon internal capital requirements. The proposal would be an unjustifiable restriction on the ability of corporations to allocate their funds on the basis of investment needs and opportunities. Fourthly, share conditions and provisions in trust deeds, mortgage bonds and other forms of debt financing (including normal bank credit restrictions) may prevent companies from paying dividends within the allotted time.

4. To the extent that integration will have the effect of making the shares of widely-held Canadian companies (other than public real estate corporations) which have creditable tax and pay dividends much more attractive, investments in other securities will be less attractive. As a result, the amount of capital available for debt financing through bonds, debentures, mortgages and similar securities will be reduced. Since real property investment

depends to a large degree on this latter type of financing, it is evident that residential and commercial construction will suffer.

5. The Institute opposes the distinction between widely-held and closely-held corporations and in particular, the need for shareholders of widely-held companies to revalue their shares every five years for the following reasons:

(a) The distinction will result in companies in the same business and of the same size being treated differently. Although some of the problems could be cured by changing the definition, there can be no doubt that the result will be inequitable.

(b) In order to pay their taxes every five years, controlling shareholders will be forced to sell their shares. These sales will require compliance with the applicable securities legislation and as such shareholders will be put to the expense of issuing prospectuses and paying underwriters' commissions.

(c) In many cases, the securities legislation requires that shares be escrowed and in such circumstances, these shares can not be sold in order to meet the tax liability. Unless the value ascribed to these

shares is less than the market price, the proposal will cause great hardship.

(d) Many shareholders will cause their closely-held companies to become widely-held companies prior to the sale of their shares in order to take advantage of the lower rate on capital gains. On the other hand, the purchaser of the shares will then be able to sell the assets of the widely-held company to a closely-held company and thereby take advantage of the full integration principle available to such corporations.

(e) As previously stated, integration will cause the shares of public real estate companies to become far less attractive and the five year rule will aggravate the situation even further.

6. If capital gains or integration are to be adopted, it is suggested that the top marginal rate of tax on dividends be reduced to 50% immediately.

7. If a capital gains tax is to be imposed, the cost base of an asset on valuation date should be equal to the greater of the cost to the taxpayer or its value at that time

and capital losses incurred prior to valuation date would not be deductible. The Institute can see no reason for limiting the use of this formulation to certain types of debt securities. Many taxpayers own assets which have declined in value from their original cost and much of this decline has been caused by the depressed state of the economy. Certainly, the anticipation of legislation implementing the integration proposal has not caused corporate shares to increase in value and it is our suggestion that all assets should be treated identically.

We also suggest that the necessity of valuing all assets on valuation date will result in considerable difficulty especially for those taxpayers who are unable to retain the services of professional valuators. We, therefore, recommend that a taxpayer be entitled to adopt a time apportionment formula as an alternative to actual value on valuation date. Thereby, taxpayers could avoid the necessity of immediate valuation and could pro rate their realized gain over the period of retention so that only the fractional amount accruing after valuation day would be taxed.

8. Although the Institute is not directly concerned, it opposes the proposal which would limit the capital gain exemption on the sale of a principal residence to $1,000 per year. In many urban areas, the amount of this exemption will

be inadequate even if inflation is controlled. In addition, it is biased in favour of less expensive homes and areas with lower housing costs. Furthermore, we do not believe that many Canadian taxpayers deal in self-occupied residences. It is recommended that a tax free "rollover" be allowed in all cases where another home is purchased within two years from the date of sale. In any event, a percentage allowance would be more equitable than the proposed exemption of $1,000 per year.

9. A substantial portion of the equity capital in the real estate industry has come from direct foreign investment. The proposals contained in Sections 6.43 - 47 of the White Paper that non-residents will be taxable on gains arising from the sale of real property and shares in widely-held companies where the vendor's interest is 25% or more may result in the diversion of capital to countries where more favourable treatment is granted. Canada cannot afford such a diversion and when this is combined with the very serious problems of enforceability, it is clear that the proposal should not be implemented.

C. WITHHOLDING TAX

In order to finance many real estate projects, it is necessary to obtain debt capital from abroad. If the rate of withholding tax on interest payments is increased from

15% to 25% as proposed under Section 6.36 of the White Paper, this source of capital may be diminished. It is, therefore, recommended that the existing rate of tax should be maintained or alternatively, that immediate priority be given to the negotiation of new tax treaties containing a 15% limitation.

D. CONSOLIDATED RETURNS:

The Institute regrets that no provision has been made for the filing of consolidated returns. It has become increasingly common that institutions participating in real estate development demand an equity interest in the project. In addition, under the Canadian and British Insurance Companies Act, insurance companies are not allowed to participate on an equity basis other than through share ownership. This means that each development must be separately incorporated in order to give effect to this situation.

Although the White Paper proposes that corporations may elect to be taxed as partnerships, the suggested restrictions indicate that the proposal will be of doubtful utility. In particular, it is rare that the fiscal year ends of all corporations involved will be the same; in many cases, there will be foreign shareholders and in any event, minority shareholders will not agree to the election unless an income distribution is guaranteed. Consequently, the

partnership option is an inadequate substitute for consolidated returns and the real estate industry will continually be faced by the existing situation whereby losses cannot be offset against income in other companies. Furthermore, for the purpose of reporting to shareholders, most financial statements are now prepared on a consolidated basis and the distinction made by the Income Tax Act between separate corporations is in conflict with this form of presentation.

E. REVENUE EFFECTS:

The Institute is concerned about the Government's estimate that implementation of the White Paper will result in increased revenues of approximately $630 million by the fifth year. Although tax reform is a worthy objective, it is made far less palatable when combined with substantial tax increases of this nature. It is suggested that many criticisms of the White Paper could be met if the additional revenue were used to provide incentives to the private sector of the economy or alternatively, if some indication were given as to the utilization of the additional funds.

CONCLUSION

In conclusion, it is abundantly clear to us that in many instances, real estate is treated differently than other types of business and in most cases, the effect is adverse. Particularly, the proposals will make it more difficult for real estate companies to obtain the financing necessary to meet the accelerating demand for residential, commercial and industrial construction. As alternatives to the proposals, the Institute suggests the following:

(1) Section 5.17 of the White Paper should not be applicable to public real estate companies.

(2) Capital cost allowances for real estate companies should not be reduced.

(3) Dividend distributions out of non-creditable tax should be treated as either a capital gain or credited to the cost base of the shares.

(4) Capital gains should be subject to a preferential rate of tax and we suggest a maximum of 25%.

(5) The five year revaluation rule applicable to widely-held companies should not be implemented.

(6) Foreign investors should not be subject to capital gains tax in Canada.

(7) Corporations should be permitted to file consolidated returns.

(8) The rate of withholding tax on interest payments should not exceed 15%.

(9) Tax reform should not result in increased total taxes.

SUMMARY

1. The members of The Canadian Institute of Public Real Estate Companies together with the real estate industry in general are restricted in their efforts to provide the necessary residential, industrial and commercial accommodation in Canada by a shortage of capital. This shortage has been largely responsible for the increase in the price of land and buildings in recent years and will be a continuing problem whether or not the White Paper is implemented.

2. If the White Paper is implemented, the availability of capital will be further reduced as a result of the following proposals:

(a) The creation of separate capital cost classes for a building costing more than $50,000 and the non-deductibility of property losses arising from capital cost allowances, interest charges and taxes will place an unfair burden on the industry.

(b) The imposition of a capital gains tax and the integration of corporation-shareholder income will reduce the rate of return on shares of widely-held Canadian companies by 15% as opposed to the present system and by 27% in the case of

public real estate companies that do not have any creditable tax. Equity financing will, therefore, become more difficult.

(c) The real estate industry relies to a large extent on debt financing. Integration will cause the shares of widely-held Canadian companies (other than real estate companies) to become more attractive and thereby reduce the source of capital.

(d) A substantial portion of the investment in Canadian real estate is derived from foreign sources. The imposition of a capital gains tax on sales of real property and the disposal of shares in widely-held companies where the vendor has a 25% or greater interest together with the increase in withholding tax rates will cause a diversion of capital to countries granting more favourable treatment.

(e) As a result of the demands by institutions and other lenders for equity participation in real estate projects, it has become necessary to separately incorporate specific projects. This situation when combined with the White Paper's failure to permit consolidated returns and the inadequacy of the partnership election discriminates

against the real estate industry as compared to most other businesses.

3. The existing shortage of capital, if further reduced as a result of implementing the White Paper proposals, will cause increased pressure on land and building prices with a consequential increase in rents.

4. Recommendations:

(1) Section 5.17 of the White Paper should not be applicable to public real estate companies.

(2) Capital cost allowances for real estate companies should not be reduced.

(3) Dividend distributions out of non-creditable tax should be treated as either a capital gain or credited to the cost base of the shares.

(4) Capital gains should be subject to a preferential rate of tax and we suggest a maximum of 25%.

(5) The five year revaluation rule applicable to widely-held companies should not be implemented.

(6) Foreign investors should not be subject to capital gains tax in Canada.

(7) Corporations should be permitted to file consolidated returns.

(8) The rate of withholding tax on interest payments should not exceed 15%.

(9) Tax reform should not result in increased total taxes.

APPENDIX "D"

THE CANADIAN GAS ASSOCIATION

SUBMISSION TO THE

STANDING SENATE COMMITTEE
ON BANKING, TRADE AND COMMERCE
ON PROPOSALS FOR TAX REFORM 1969

MAY 5, 1970.

The Canadian Gas Association is the corporate representative and collective voice for the production, transmission and distribution companies and equipment manufacturers in Canada's natural gas industry. In the comments and recommendations which follow on the tax reform proposals we intend to confine ourselves only to matters affecting investor-owned production transmission and distribution companies, whose total investment currently in debt and equity securities issued is in excess of three billion dollars. We expect that the views of our equipment manufacturer members will be adequately expressed in briefs to be presented by other Associations. A brief history of our Association is attached. (see Exhibit "A")

This Association previously made a "Submission to the Royal Commission on Taxation" and on receipt of its recommendations made a further "Submission to the Honourable Minister of Finance of Canada" indicating our continuing interest and concern with constructive tax reform.

In a brief dated February 12, 1970 submitted to your committee on the White Paper on Tax Reform we requested deletion of paragraphs 4.63, 4.64, and 4.65 from the proposals. These proposals are adversely affecting the equity financing of investor-owned gas distribution utilities as a result of the proposed denial of dividend tax credits to shareholders of these corporations.

Tax reform on the scale proposed by the Government affects every Canadian. Any changes in tax laws must be compatible with the overall taxing

system in order to provide a system which meets the various important aims of tax reform. This White Paper does not deal with such matters as sales and excise taxes, capital cost allowances, and estate taxes, which are a vital and integral part of a total tax reform package. Also, it merely provides a sketch of the tax reform proposals. It is impossible to properly evaluate the present proposals without the benefit of the Government's thinking on the total tax system as well as further detail underlying the proposals.

We have however carefully studied the limited information provided in the White Paper and have reached the conclusions included in the following summary.

SUMMARY

1. *Proposals to provide a new system of credits to shareholders for corporate taxes paid in place of the present dividend tax credit system.*

We recommend that the proposal to provide a new system of credits to shareholders for corporate taxes paid be reconsidered. Possibly an alternative system can be devised that would not produce the undesirable results that the new system offers. In the meantime the present system should be maintained.

The adverse effect on equity and convertible debt financing of growth companies resulting from these proposals is inconsistent with the main objective for economic growth and productivity.

The proposed system would result in pressure on growth corporations not to declare dividends.

The proposed system would provide an incentive for investment by United States investors in equities of the Canadian natural gas industry rather than encourage Canadian ownership of Canadian business.

The tax credit system and the depreciation system would work in opposite directions. For a growth corporation, the tax credit system offers a deterrent offsetting the capital cost allowance system.

The proposed system would result in a reduction in profits of a public corporation receiving dividends from another public corporation providing less than $50. creditable tax per $100. dividend.

We feel that creditable tax should be based on actual corporate tax rates imposed rather than an arbitrary 50% rate.

The proposed tax credit system would result in administrative complexity and investor uncertainty.

2. *Capital Gains Tax*

We recommend that the proposals to tax capital gains be given further consideration. In the event that a capital gains tax is imposed, the rates should recognize inflationary trends and the tax should not interfere with investments needed for productivity and public purposes. Such a tax would have an adverse effect on financing required to develop our industry.

We are particularly concerned about the proposed tax on unrealized capital gains on public company shares since investors in growth companies who would normally continue their investment may be forced to sell shares to pay the tax.

3. *Withholding taxes on debt interest.*

Foreign investors should be encouraged to invest in debt rather than equity capital of Canadian business. Increased withholding tax on debt interest would increase interest costs to Canadian borrowers. We recommend that withholding taxes not be imposed on debt interest.

4. *Natural Gas Exploration, Development and Production*

The purposes for providing the present incentive continue to be important to the development of Canada's natural gas resources and the location of highly-productive industry in areas with lesser growth. We feel that the present system for depletion allowances should be continued.

5. *Depreciation*

We recommend that the incentive provided for growth of the Canadian economy through capital expenditures by business be continued. The present capital cost allowance system should be continued unless an improved alternative system can be designed to provide a similar incentive.

6. *Taxation of Electric, Gas or Steam Utilities (Section 85 of the Income Tax Act)*

We recommend that the provisions contained in Section 85 of the Income Tax Act be continued for utility companies.

7. *Business expense - nothings*

We recommend that all proper business expenditures should be tax deductible, either currently or over a period of years.

We feel that the Government should state its intentions on certain "nothings" referred to in our comments.

We recommend that consideration be given to allowances on certain "capital nothings" existing at the time of implementation of the tax reform changes.

8. Business expense - entertainment and related expense

We recommend that all proper business expenses be tax deductible. We feel that stronger administration is required rather than the proposed arbitrary disallowance of a proper business expense.

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1. *Proposals to provide a new system of credits to shareholders for corporate taxes paid in place of the present dividend tax credit system.*

Introduction

The Government proposes to discontinue the present system which provides a 20% tax credit to resident Canadian individual shareholders and a tax free receipt to resident Canadian corporations on dividends paid by all taxable Canadian corporations. It proposes to provide a new system of credits to shareholders for corporate taxes paid whereby credits would vary with the creditable tax of the dividend declaring corporation.

In our brief of February 12, 1970 we stated our intention to express our views on the concept of the proposed system of credits to shareholders for corporate taxes paid. We are strongly opposed to the proposals to discontinue the present dividend tax credit system and replace it with the new system.

Economic growth and productivity

With the present 20% dividend tax credit system individual shareholders with marginal tax rates of 33-1/3% and 50% receiving a $100 dividend retain net after tax proceeds of $86.67 and $70.00 respectively.

With the new system the amount retained by the individual shareholders of widely-held Canadian corporations would be substantially unchanged if the $100 dividend was received from a corporation providing a $35 tax credit. The amount retained would be greater than at present if the tax credit exceeds $35 and the advantage would increase as the tax credit increases. Conversely, the amount retained would be $20 less than at present if the dividend was received from a corporation

providing no tax credit. (See Exhibit "B")

The proposals to discontinue the present dividend tax credit and provide a new system of tax credits are adversely affecting the equity financing of Canadian corporations with relatively less creditable tax. We are particularly concerned about this adverse effect on members of our Association.

Our industry plays an important role in the development and production of Canada's natural gas resources. To provide a vital public utility service, it must bring the gas from the gas fields to the customer. Also, the export of natural gas to United States assists the Canadian economy in balance of payments. Our industry continues to require major amounts of capital since we are faced with rapid growth and by nature are highly capital intensive.

A stated "main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity", and to ensure that "investments needed for productivity and public purposes are not rejected in favour of less desirable alternatives just because of their tax consequences". The adverse effect on equity and convertible debt financing of growth corporations in our natural gas industry resulting from these proposals is inconsistent with this stated objective.

To attract equity and convertible debt capital a corporation with relatively less creditable tax would be forced to increase dividends to provide a competitive yield and this increased cost would have to be passed on to the customer. It would be inappropriate to introduce these inflationary proposals at a time when both Government and industry are waging a war against inflation.

Risk of foreign control of Canadian business

"The Government does not propose to give foreign shareholders of Canadian corporations credit for the tax paid by those corporations" (Paragraph 4.49).

Accordingly if the international taxing community accepts this, the new tax credit system would not cause an unfavourable valuation by foreign investors of shares of corporations with relatively less creditable tax.

The shares of gas industry growth corporations have already received an unfavourable valuation by the investing public. The Canadian investor is weighing the proposals and adjusting the price to achieve a competitive net after tax yield. The shares of these corporations have therefore, become more attractive to foreign investors since the depressed value results in a higher than competitive yield to them. An attempt to regain a favourable valuation of these shares for Canadian investors by means of an increased rate of return would increase the higher than competitive yield to foreign investors.

Under present United States tax regulations, a corporation with more than ten percent ownership of the stock of a Canadian corporation, not only gets credit for withholding tax on dividends received but also for the Canadian Federal and Provincial corporate taxes paid by the declaring company.

Looking at the stated main points to be met in tax reform, it is noted that the new system of tax credits is intended to "stimulate Canadian ownership of Canadian business", "provide a powerful incentive" and "offer a substantial inducement" for such Canadian ownership.

The powerful incentive for foreign ownership of shares of Canadian natural gas industry corporations is inconsistent with these stated aims. We see the definite risk of a major shift to investment by United States investors in the Canadian natural gas industry.

Payment of dividends

The unfair tax burden that would be imposed on shareholders receiving dividends from growth corporations with no creditable tax would result in pressure not to declare dividends. Growth corporations require large amounts of capital. However, payment of dividends might be necessary for financial purposes and because of intercorporate relationships.

Non-payment of dividends due to tax considerations is inconsistent with the aim for a "relatively balanced system in which there is little incentive for Canadians to receive their income in the form of capital gains rather than dividends, or vice versa". (Paragraph 3.35).

Intercorporate dividends

A $100 dividend received by a widely-held Canadian corporation from another widely-held Canadian corporation providing a tax credit of $50 would not result in additional tax. The tax credit would flow through to the shareholders of the recipient corporations.

However, a $100 dividend received by a widely-held corporation from a widely-held corporation providing no tax credit would result in $33 of additional tax.

Dividend received	$100
Plus taxable credit	-
Taxable amount	$100
Gross tax - 33-1/3%	33
Less credit	-
Net tax	$ 33

Under the present law, dividends received by one Canadian corporation from another taxable Canadian corporation are exempt, regardless of the tax paying position of the declaring company.

The new system for taxation of such dividends would result in a reduction in cash flow to the recipient corporation. Once again, in order to attract future investment, price increases would be required which would be inflationary.

Administrative complexity and investor uncertainty

The proposed tax credit system would result in administrative complexity and investor uncertainty.

Records would have to be maintained by corporations to identify creditable tax by vintage. Creditable tax lost due to not being passed on to shareholders within 2½ years would be deleted and the vintage of dividends and creditable tax would have to be matched.

Apparently a tax credit of $50 on a $100 dividend would be available on an early distribution if creditable tax for the vintage year was sufficient. A lower amount of creditable tax, if any, would remain for subsequent dividends where total tax credits were less than 50% of profits available for distribution.

It would be necessary to determine the rights of the various issues of preference shares and the common shares as to the allocation of such tax credits available.

Recommendation

We recommend that the proposal to provide a new system of credits to shareholders for corporate taxes paid be reconsidered. Possibly an alternative system can be devised that would not produce the undesirable results that the proposed new system offers. In the meantime the present system should be maintained.

2. *Capital Gains Tax*

Self assessment and efficient administration

A tax system should lend itself to effective self assessment and efficient administration. The proposed method of taxing capital gains would encourage taxpayers to avoid payment of tax on personal assets and create overwhelming administrative problems.

The valuation of corporate and personal assets would be a matter of opinion. Due to their nature the valuation of certain assets would be arrived at using an arbitrary basis. The gas industry would be required to value all its assets on valuation day with a view to their possible sale. The valuation of our assets such as gas reserves, rights-of-way for pipelines and franchises would be particularly difficult as a basis for market values are not available.

At the time of sale of assets, the valuations arrived at by the taxpayer on valuation day would be examined by the Government and in many cases long and expensive litigation would result to settle the amount of the capital gain.

Economic growth and productivity

The proposals would interfere with the economic growth of our industry which provides a vital service to the public. Members of our industry such as gas pipeline corporations continue to require substantial funds to provide the facilities for service to domestic and foreign markets.

These corporations pay relatively low dividends during the expansion period. A low level of creditable tax would be

available on such dividends due to the capital cost allowance incentive for growth. Investors are attracted to the shares of these corporations by the potential earnings and dividends resulting from growth. The investing public has already placed an unfavourable valuation on the shares of these corporations due to the adverse effect of the combination of proposals for a new tax credit system and a capital gains tax. This would result in great difficulty in raising development capital for our industry.

The increased cost of debt and equity financing which would result from implementation of these inflationary proposals would flow through to the consumers. A stated aim of the tax reform proposals is "Some proposals in this paper are intended to ensure that the incentive to work and invest is not unduly inhibited and that investments needed for productivity and public purposes are not rejected in favour of less desirable alternatives just because of their tax consequences". Clearly, the adverse effect on financing of these corporations which provide a vital public service is inconsistent with this stated aim.

Fairness in taxation

Taxation of accrued gains in the value of shares would be a tax on unrealized capital appreciation and represents an appropriation of capital.

It is inequitable since it would treat similar investments differently. A person or corporation whose anniversary is divisible by five in a year in which market values are high would be required to pay a tax on the increased value. This shareholder might have to sell shares of the corporation to pay the tax. This would be particularly unfair where a shareholder intended continuing investment and was required to sell at a subsequent lower price to pay the tax. A shareholder with a

minimum controlling interest could lose control. In the following year a low market value could provide a refund of tax for another shareholder on shares of the same company. This inequity may not be corrected in the future as the investor may have a lower rate of tax when a deemed loss is taken into account.

A stated aim of tax reform is that "People in similar circumstances should carry similar shares of the tax load". Clearly, the treatment of shareholders of similar corporations differently is inconsistent with this stated aim.

The proposed system does not recognize inflationary trends and tax would be paid on ficticious gains. For example, an asset purchased in 1961 at the price level of $1.00 would be worth $1.279 in December 1969 based on the purchasing power of the 1969 dollar in relation to the 1961 dollar. Imposition of tax on an increase in price levels could result in a tax when a "real" loss exists.

Canadian ownership of Canadian business

The proposal to impose Canadian tax on accrued gains of foreign investors appears contrary to the stated aim of encouraging Canadian ownership of Canadian industry. Foreign investors who establish a controlled public company with Canadian equity participation would be penalized as they would be subject to a tax on unrealized capital appreciation. However, foreign investors who establish wholly-owned subsidiaries in Canada would not be subject to tax until the subsidiary is sold which, in many cases, would be unlikely.

Recommendation

Canada is a rapidly growing country in need of capital to develop its resources and industries. We are of the opinion that a capital gains tax is not in Canada's best interests as it would lessen the availability of development capital. We feel that a tax on unrealized gains on shares of public companies would have a serious adverse effect on the financing of resource-orientated companies.

If realized capital gains are to be subject to tax, we recommend that a relatively low rate of tax be applied which would recognize inflationary trends and which would not deter investment in capital assets.

3. *Withholding Taxes on Debt Interest*

Foreign ownership of Canadian industry is of great concern to all Canadians. However, attraction of foreign capital is essential to the development of the Canadian economy. Therefore, foreign investors should be encouraged to invest in debt rather than equity capital of Canadian business.

Withholding taxes are a major consideration in determining interest rates and many Canadian borrowers are required to indemnify foreign lenders for unrecoverable Canadian withholding tax on debt issues. As a result, such taxes effectively increase interest costs to Canadian borrowers.

The adverse effect which withholding taxes impose on debt issues was recognized by the Government of Canada in its waiver of withholding tax on debt issues of Churchill Falls (Labrador) Corporation. In the Department of Finance News Release of April 30, 1968, it was stated "without the exemption from withholding tax, the sale of such a very large issue of bonds in the United States might be impossible and in any event would be unduly costly".

The withholding tax on debt capital is not a sufficiently important source of revenue for Canada to justify the restrictions which it imposes on attracting debt capital. Total withholding taxes from all sources, including interest, dividends, rentals and royalties, amounted to 2.02% of total budgetary revenue for the year ended March 31, 1969. Revenues lost by withdrawal of the withholding tax on debt issues would be partly offset by Government revenues gained through lower deductions as a result of reduced interest costs. The slight decrease in Government revenues would be justifiable since it would encourage foreign investors to invest in debt rather than equity capital.

Recommendation

We recommend that withholding taxes not be imposed on debt interest.

4. *Natural Gas Exploration, Development and Production*

Depletion

The White Paper proposes that depletion allowances would be continued for mineral (including natural gas) producers, but the amount of depletion allowance would be limited in the future to one-third of the drilling and exploratory expenses incurred. A taxpayer would only be entitled to deduct maximum depletion if he spends sufficient amounts on these eligible expenditures.

The White Paper gives recognition to the inherent risks that are evident in the exploration and development of gas deposits but in turn, proposes legislation which would essentially increase the tax burden for the natural gas production industry.

The value of natural gas production since the end of World War II has risen some thirty-fold. Much of this growth can be attributed to present legislation entitling the operators of natural gas wells to claim depletion allowances without limit in respect of profits derived from the production of the resource. The emergence of natural gas as a major mineral has resulted in a highly productive industry in areas of Canada outside those where rapid urban and industrial growth are already occurring, thereby creating better regional economic balance. Present tax incentives have assisted the natural gas industry in maintaining a strong international position. Overall, the present legislation has contributed to a stronger and healthier growth of the Canadian economy.

The industry's ability to attract both Canadian and foreign capital and to generate savings internally are enhanced by the present tax legislation. Any reduction in the tax incentives

as proposed within the White Paper would reduce the return on capital invested within the natural gas industry and reduce the level and range of future exploration and development. An incentive would be created to divert exploration out of Canada and to invest in other markets.

It is important that Canadian incentives for the natural gas industry be similar to those within competing countries. Even the recently amended United States tax legislation provides for depletion incentives on a far more generous scale than proposed in this White Paper.

It follows that the proposed reduction in the depletion incentive would result in a demand for higher well-head prices for gas to provide an equivalent return to that being received under the present system. Inevitably, there would be an increase in the cost to the consumer or user of natural gas and its products adding to the present inflation problem.

Recommendation

We feel that the present system should be continued.

Capital gains tax and new system of credits to shareholders for corporate taxes paid.

The implementation of the proposed capital gains tax and the new system of credits to shareholders would result in a serious adverse affect on the growth of the natural gas exploration, development and production industry.

The prospect of capital gains in this high-risk business is a prime motivation for investment. Also, a relatively low level of creditable tax would be available due to the tax incentives

for exploration and growth.

Recommendation

We recommend that the proposed capital gains tax and new system of credits to shareholders be reconsidered.

5. *Depreciation*

In the White Paper "the government intends in due course to invite briefs on the system and rates of capital cost allowance". (Paragraph 5.14). Depreciation is a vital and integral part of the total tax reform package and must be considered at this time.

The present capital cost allowance system and rates have provided an important incentive for growth of the Canadian economy through capital expenditures by business. Present expenditures were made on the assumption that this system would continue. Continuation of this incentive is essential to the future development of the Canadian economy.

A stated aim of the White Paper is "the second main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity". (Paragraph 1.10). A reduction in the depreciation incentive would be inconsistent with this stated aim.

Recommendation

We recommend that the incentive provided for growth of the Canadian economy through capital expenditures by business be continued. The present capital cost allowance system should be continued unless an improved alternative system can be designed to provide a similar incentive.

6. *Taxation of Electric, Gas or Steam Utilities (Section 85 - Income Tax Act)*

Under existing legislation, Section 85 of the Income Tax Act, certain electric, gas and steam utilities are granted a limited income tax rate reduction on income attributable to the sale for delivery in Canada of electrical energy, gas or steam. However, as part of the new system for taxing Canadian corporations, the government would appear to establish a single rate of corporation tax applicable to all corporations. This proposal might therefore repeal the existing provisions under Section 85.

This legislation was introduced to provide relief for these public utility companies. In view of the nature of their business, these utilities are required to raise large amounts of capital for the expansion of public services within their franchise area. To a large extent such expenditures are non-discretionary. Also because of the public control of rates, these utilities are allowed to earn only a limited return on this capital. It was anticipated by the government that this relief might assist such companies in attracting the required capital.

In order to keep pace with the rapid development of the Canadian economy, these utilities must continue to grow with the expanding communities thereby increasing the need for future capital requirements. Existing provisions under Section 85 must be continued within the tax reform proposals to enable this future expansion of gas, electric and steam corporations.

Recommendation

We recommend that the proposed system for taxing Canadian corporations be enacted to maintain existing provisions granted under Section 85 of the Income Tax Act for electric, gas and steam utilities.

7. *Business Expense - Nothings*

The proposal of a new depreciation class that would allow depreciation of "capital nothings" is welcomed.

We feel that all proper business expenditures should be tax deductible. In certain cases depreciation or amortization over a period of years is appropriate. For other items current deduction is appropriate.

The proposals specifically refer to "goodwill" and "capital nothings", but we are uncertain as to the Government's intentions on such as the following items and request clarification that they will be either currently deductible or depreciable:

> Organization expense, fees paid to underwriters for capital financing, discount on the issue of debt capital, presently non-deductible foreign exchange, rights-of-way with a nominal perpetual life and interest expense on such as funds borrowed for payment of dividends.

Since this change is long past due it seems reasonable that an allowance should be made for all such "nothings" still included among the assets of business.

Recommendation

We recommend that all proper business expenditures should be tax deductible, either currently or over a period of years.

8. *Business Expense - Entertainment and Related Expenses*

We feel that all reasonable business expenses should be tax deductible. Gas industry corporations are required to incur costs of this nature for legitimate business purposes of benefit to the company.

In this era of rapidly changing and expanding technology, it is vital for the economy and growth of our industry to keep abreast of these changes. Seminars, workshops and the annual meetings of business and professional associations provide a forum where employees may participate to obtain information through formal presentations and by the exchange of ideas with individuals sharing a common interest.

Management strives to maintain adequate control through budgeting, authorization and approval of these costs. Moreover, in the case of our regulated members, the authorities periodically review these costs to ensure that they meet the test of being reasonable business expenses properly chargeable to customers.

Recommendation

We recommend that all proper business expenses be tax deductible. We feel that stronger administration is required rather than the proposed arbitrary disallowance of a proper business expense.

EXHIBIT "A"

THE CANADIAN GAS ASSOCIATION

History

The aims of the Association are the same today as they were when it was founded by the representatives of twelve Ontario utilities in 1907 to solve the common problems of its members, to promote the greater use of gas and to establish and maintain safety standards for the industry.

In 63 years, the Association has grown into an organization operating from coast to coast, providing liaison between the gas industry and the Canadian public and serving as spokesman for the industry at the various levels of government.

Various committees and sub-committees provide the member companies with advice and information and a forum for exchanging ideas and developments.

A professional staff administers day-to-day operations of the Association's secretarial, accounting and inspection departments and the industry's national marketing and public relations programmes.

Several years ago, the Association organized its approvals division which has since been responsible for testing and approving all gas-fired equipment manufacturered and sold in Canada.

Chief benefactor of this approvals programme which the industry has imposed on itself - and of the other services rendered by the Association is the Canadian consumer who is thus guaranteed an unequaled standard of safety, reliability and performance.

EXHIBIT "B"

PROPOSALS TO PROVIDE A NEW SYSTEM OF CREDITS TO SHAREHOLDERS
FOR CORPORATE TAXES PAID IN PLACE OF THE PRESENT DIVIDEND TAX CREDIT SYSTEM

Illustration of the Effect of the Proposed New System
on Widely-Held Corporations

Marginal tax rate of shareholder	33-1/3%			50%		
Tax Credit	$ 0	$ 35	$ 50	$ 0	$ 35	$ 50
Dividend	100	100	100	100	100	100
Taxable Credit	0	35	50	0	35	50
Total	100	135	150	100	135	150
Tax	33	45	50	50	67	75
Tax Credit	0	35	50	0	35	50
Net Tax Payable	33	10	0	50	32	25
Net after tax proceeds	$ 67	$ 90	$100	$ 50	$ 68	$ 75

APPENDIX "E"

SUBMISSION

REGARDING WHITE PAPER

ENTITLED

"PROPOSALS FOR TAX REFORM"

CANADIAN ASSOCIATION

OF

OILWELL DRILLING CONTRACTORS

CALGARY, ALBERTA

APRIL 27, 1970

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Section I

INTRODUCTION

The Canadian Association of Oilwell Drilling Contractors (CAODC) welcomes the opportunity of presenting its views on the Proposals for Tax Reform (the 'White Paper') released in November 1969 by the Honourable E.J. Benson, Minister of Finance. CAODC wishes to extend its appreciation to Mr. Benson for providing Canadians with the opportunity to review and comment on the proposed tax reforms while they are in the White Paper stage. The Association looks forward to discussing its brief with the House of Commons Finance, Trade and Economic Affairs Committee and the Senate Banking, Trade and Commerce Committee.

The Canadian Association of Oilwell Drilling Contractors was incorporated on June 18th, 1949, for the purpose of improving the status of the oilwell drilling and contracting industry as a whole, and of providing convenient and ready means for cooperation in the study and dissemination of information considered to result in the mutual benefit of the oilwell drilling contracting industry, the petroleum industry generally, and the economy of the nation. It presently is composed of:

(a) 43 drilling contractor members owning 335 oilwell drilling rigs, representing virtually 100% of the industry;

(b) 27 service rig members owning 170 rigs; and,

(c) 77 associate members consisting of manufacturers, suppliers (including drilling mud and chemical companies), oil, safety, equipment rental, catering, housing and camping companies, and insurance brokers, etcetera.

Currently, the oilwell drilling and servicing industry employs over 6,500 people with combined wages and salaries of about $42 million. Thus, although composed of many small businesses, the industry is reasonably large by Canadian standards.

The brief commences with background information about the characteristics of oilwell drilling and servicing. Because this contracting service is a highly specialized phase of the petroleum industry which is unfamiliar to most Canadians, this background information should place the reader is a better position to assess this submission.

The principal portion of the submission deals with major subjects of concern to CAODC. Omission of certain proposals does not necessarily mean that the Association supports or rejects them.

In the interests of brevity, the submission does not deal with White Paper proposals which it considers to be favourable, including:

1. increase in personal exemptions to give tax relief to those with lower incomes;

2. deduction of child care expenses that face many working mothers today;

3. taxation of unemployment insurance benefits and deductions of UIC contributions by employees;

4. removal of the Canadian tax exemption on teaching salaries of visiting professors and teachers;

5. elimination of 'tax havens';

6. partial deductibility of employee costs of earning their living; and,

7. partial deductibility of employee cost of moving.

The brief concentrates on White Paper proposals which directly or indirectly affect the oilwell contract drilling and servicing industry, its employees and shareholders. The Association is in the best position to assess these impacts and has a responsibility to the industry and to the government to bring its views forward.

Section II

SUMMARY AND RECOMMENDATION

A. SUMMARY

1. In 1947, foreign-owned companies met most of the oilwell drilling and servicing needs in Canada. At present, virtually all of these needs are provided by Canadian-owned companies. This shift in ownership occurred under existing income tax legislation, and is consistent with government objectives to promote Canadian ownership.

2. The 'ability to pay' basis for fairness and equity in taxation proposed by the White Paper gives no consideration to investment risks. Unless tax incentives are available to compensate risk-taking, investors will divert their capital to relatively secure investments.

   Without tax incentives that recognize the risk problems, Canadian oilwell drilling and servicing contractors cannot make the substantial investments required for increased operations in the Canadian north and offshore which involve greater risk than the industry has previously experienced.

3. The White Paper proposals reflect a political philosophy which will have the effect of increasing the relative importance of the public sector of the Canadian economy. If implemented, the proposals will provide sizeable revenues for programs which have not been identified by the government or approved by the voters. CAODC rejects these two propositions.

At the same time, the obvious dis-incentives reflected in the proposals seem contrary to established and long standing government policies, particularly those relating to education, training, retraining, and financial or technical assistance to industry.

4. The basis of the proposal for taxation of capital gains seems unfounded, as reflected by the White Paper's statements relating to:

(i) 'surplus-stripping', which CAODC believes is no longer a problem;

(ii) the proposal to write off capital losses, which is of little value to an entrepreneur with his capital and earnings tied to one company such as a drilling or servicing operation;

(iii) the unworkable and unfair valuation day and deemed realization concepts; and,

(iv) combined impact of estate and capital gains tax which could create serious problems in connection with a drilling or servicing business which normally does not lend itself to minority interests.

5. The White Paper admits that its capital gains proposal, if implemented, will be a relatively unimportant source of revenue. On the other hand, it will be punitive to the individual because it will be superimposed on personal income and will likely be taxed at the maximum rate in many cases. If the government is sincerely interested in encouraging Canadians to invest in its economic development, capital gains should be tax exempt. If implemented, such a tax should be separate from personal income tax rates and its effective rate at all levels of taxable income should be significantly lower than that levied in the U.S. In any case, there should be no capital gains tax on unrealized capital gains.

6. The proposal to tax realized capital gains on the sale of prinicipal residences should be dropped.

7. The proposal to distinguish between closely-held and widely-held companies on the grounds that they do not compete with each other is erroneous. Therefore, any specific tax proposals based on this error should be rejected. CAODC suggests that the present tax credit system should be maintained with those modifications noted in Section VI rather than moving into the proposed creditable tax method.

8. The proposal to tax goodwill represents retroactive taxation which will impair investor confidence. The White Paper specifically states that the reforms should not have a retroactive effect.

9. The proposal regarding allowable expense accounts is too inflexible and fails to recognize legitimate differences between advertising and sales promotion methods used effectively by different industries. The sales promotion methods necessary in the drilling and servicing industry are much more personalized and therefore much different from those used to sell soap or automobiles.

10. The White Paper admits that implementation of its proposals will reduce investment in the petroleum industry and yet, at the same time, acknowledges that Canada must maintain a hospitable investment climate.

This admission about investment in petroleum sincerely concerns CAODC as its members are wholly dependent on that industry.

During the 1970s, the exploration and petroleum industry will require at least $20 billion for new investment if it is to be in a position to meet the demand for Canadian oil and gas. Because of the worldwide shortage of capital, Canada will be

in competition with other countries for these same investment dollars.

11. The White Paper also admits that implementation of its proposals will reduce investment in closely held companies. CAODC is also concerned about this statement, since the majority of its members are closely held companies.

12. The White Paper has under-estimated the adverse effect that implementation of the White Paper proposals would, of necessity, have on emigration of highly-skilled professional and technical employees of the petroleum industry from Western Canada.

13. The oilwell drilling and servicing industry has provided tens of thousands of full-time and part-time jobs, particularly for farm and other rural residents in Western Canada. In addition, it has created attractive opportunities for businesses located in many small communities close to drilling operations and indeed has created entirely new rural communities. Examples include: Drayton Valley and Rainbow Lake in Alberta, Estevan and Swift Current in Saskatchewan, and Fort St. John and Fort Nelson in British Columbia.

14. Many of the White Paper proposals are extremely complex and therefore in conflict with the White Paper objective of simplicity and widespread understanding.

B. RECOMMENDATION

The matters referred to on page 3 of Section I of this submission could largely be incorporated into the present Act. However, it is unrealistic for the Minister of Finance to expect the public to suggest alternatives to specific White Paper proposals which they find unacceptable, for reasons which are identified in Section IX.

The only logical procedure is to retain the present Income Tax Act, modified gradually to incorporate reasonable changes acceptable to the taxpayer, business community, and government. This approach would eliminate existing uncertainty associated with introduction of a totally-new untested tax reform bill, and would preserve the legal precedents established over a long period.

Section III

CHARACTERISTICS OF THE OILWELL DRILLING AND SERVICING INDUSTRY

Oilwell drilling and servicing is a highly specialized industry required for petroleum exploration and development. In effect, a drilling rig is a highly mechanized self-contained mobile factory. Its sole function is for drilling holes that can be completed to permit recovery of oil or gas. The servicing rig provides for (1) completion of a well prior to production, and, (2) remedial work necessary in order to maintain production.

A drilling rig is a composite of structures, machinery, instrumentation and other parts. The value of onshore rigs varies from $350,000 to $1,250,000. Drilling capacity of these rigs ranges from 1,500 feet to 20,000 feet. (Large offshore drilling units specifically designed for oil exploration off coastal seaboards may cost as much as $12 million.) The value of a servicing rig ranges from about $100,000 to $400,000. Many other kinds of companies and organizations are involved in drilling and servicing operations, including drilling mud and drilling bit suppliers; well coring, testing, cementing and electric-logging companies; and, truckers.

Contract oilwell drilling and servicing companies and related supply companies are wholly dependent on the level of exploration and development expenditures in the petroleum industry. Therefore, any developments, such as tax reform measures, which deter investment in petroleum exploration and development in Canada will have a direct and adverse impact on the Canadian oilwell drilling and servicing industry. There are no alternative uses for drilling and servicing rigs, which have a comparatively low break-up value.

The widely-scattered location of exploration and development activities of the petroleum industry can create logistics problems for a drilling or servicing contractor. For example, a drilling rig may be moved as many as 20 times per year over distances varying from one-half to several hundred miles, which is an expensive operation. The cost of moving a medium-sized (400-ton) rig a distance of 100 miles over comparatively accessible and easy terrain, such as southeastern Alberta, would be about $5,000. The costs of moving a large-capacity (800-ton) rig to a remote location has exceeded $250,000.

Contractors must have the capability to move rigs on very short notice. Because speed and efficiency in rig-move and

PANARCTIC OILS — ARCTIC DRILLING

COMMONWEALTH HI-TOWER ARCTIC JOINT VENTURE RIG #1
DRILLING DRAKE POINT WELL ON MELVILLE ISLAND

rig-up are so essential, loads are highly unitized. As many as 30 specialized oilfield trucks are required to move a medium-capacity rig. (Some oilfield trucks are capable of handling 40-ton loads.) Drilling contractors generally hire rather than own trucks required for rig movement, which provides significant revenues to local truckers who specialize in transportation of oilfield equipment.

In order to remain competitive in the future, drilling and servicing contractors will have to adjust the capacity and design of their respective equipment to provide for the expected increasing relative importance of exploration and development activities in northern and offshore areas, and the expected trend towards deeper drilling. Logistics problems for northern operations are more complex because of the need to further develop rigs that can be transported by aircraft, helicopters, tracked vehicles and perhaps even by hovercraft, or which can be moved to drilling sites by more indirect routes using conventional transportation media. Drilling and servicing contractors will have to make substantial capital investments to adjust to this increasing trend towards northern, offshore and deeper drilling in the continuing search for hydrocarbon reserves.

About 80 per cent of oilwell drilling operations are contracted for on a fixed fee per foot drilled basis. Thus, the con-

tractor must absorb all costs, including unplanned and expensive 'fishing' costs to recover objects lost in the hole. Operating costs associated with drilling normally run between $1,500 and $3,000 per day. Therefore, if it takes three days longer than estimated to complete a well, added costs to the contractor would be $4,500 to $9,000. 'Fishing' costs may increase operating costs by $2,500 to $3,000 per day. If movement of a rig is halted due to weather conditions, the added transportation costs are generally absorbed by the contractor. During such delays, he must also keep his 15-man drilling crew on the payroll. The drilling contractor also faces risks of a geological nature, such as loss of drilling mud circulation or a higher degree of abrasion than anticipated. Because of these and other inherent risks, it is impossible to accurately predict net cash inflows from a drilling operation. As the relative importance of northern drilling becomes more significant, the risks associated with transportation of rigs into and from northern drilling sites will also increase in relative terms. This northward trend will increase the difficulty and costs of financing drilling operations.

Contractors also face the risk of having no work for one or more rigs because of a sudden shift by petroleum companies from one geological exploration 'play' to another 'play' some distance

away. Under such circumstances, the contractor must attempt to assess the duration of such a shift. He must then decide whether to keep the available rigs at their existing location with no work or to move them to the new 'play' at his own expense.

At the time of the 1947 Leduc discovery, the demand for oilwell drilling and servicing was met almost entirely by United States contractors who moved into Canada with equipment and know-how. In time Canadian-owned contracting firms were formed. At present, there are 43 drilling contractors (owning 335 rigs) and 27 servicing contractors (owning 170 rigs) operating in Canada. Total investment of these contractors, including investment in 2 offshore rigs, probably totals about $250 million. The investment in related supply companies is not included in this amount.

About 90 per cent of the drilling contracting companies and rigs are Canadian-owned. Over 90 per cent of the servicing contracting companies and about 85 per cent of their rigs are Canadian-owned. This trend towards a comparatively high degree of Canadian ownership has occurred under existing income tax legislation.

Section IV

FAIRNESS AND EQUITY IN TAXATION

One of the five goals and standards which guided the authors of the White Paper in the approach to tax reform was "a fair distribution of the tax burden based upon ability to pay . . ." (1.6). The White Paper also states:

> "Fairness in taxation implies . . . that people in similar circumstances should carry similar shares of the tax load . . . This concept of fairness must shape the standards we apply in stating just what income is." (1.8)

> "Fairness also requires that people with higher incomes, people who are better off, should be expected to pay in taxes a larger share of their incomes than persons with lower incomes. This concept of "ability to pay" is embodied mainly in the personal income tax as a progressive graduated tax having increasingly higher rates as income increases." (1.9)

The ability to pay approach to apportioning the tax burden takes the position that taxes are equitable when they are levied according to a defined capacity of individuals or groups. 1/

CAODC believes, however, that if each taxpayer is taxed according to capacity (that is, according to the number of dollars under his control), consideration is not given to the risks assumed by

1/ Royal Commission on Taxation, Volume 3, page 3.

the entrepreneur or investor. A fair and equitable tax system must provide for such risks. Investors must be able to accumulate capital which generates economic activity. Gains or yields realized by investors should increase as investment risks increase. For example, investors look for a higher yield from a mining company than from a public utility company which has the protection of a franchised market area. Similarly, the rate of return permitted on one utility company will be higher than the return permitted on a utility company with lesser risk.

Certain White Paper proposals or comments recognize that tax incentives are worthwhile. For example, it proposes specific expense allowances as an incentive or benefit to working mothers. Similarly, the White Paper states, and CAODC agrees, that the present capital cost allowance system has served Canada well. The White Paper points out that "one of the reasons that it works so well may be because, on balance, the rates tend to be on the generous side." (5.14)

It is regrettable that the White Paper did not recognize the value of incentives throughout all its tax reform proposals. Unfortunately, certain opinions expressed in the Paper in connection

with incentives and fairness are completely misleading. For example, in paragraphs 3.1 and 3.2, it is suggested that capital gains must be taxed ". . . if Canada's tax system is to be fair, and if it is to be effective." To illustrate its point, the White Paper refers to an over-simplified hypothetical case of two neighbours, one who makes a substantial stock market gain or real estate profit. The White Paper illustrates this by stating:

> "A Canadian who is able to realize a substantial stock market profit or real estate gain clearly has an increased ability to pay; he is better able to pay for a new car, or to pay for stocks and bonds, or to pay income taxes, than is his neighbor who has not had such a gain. At present, Canada does not tax this ability to pay. As a result, some very well-to-do Canadians pay far less tax than others with similar abilities to pay, and less even than others with much lower incomes (all because these particular Canadians receive a large part of their income as "capital gains")." (3.2)

CAODC believes this example is misleading, and, therefore, must be discounted or ignored in any objective assessment of fairness and equity in our tax system. CAODC feels it is essential to dwell on paragraphs 3.1 and 3.2 since they seem to typify the errors in the White Paper's assessment of investor motivation.

The hypothetical example makes no reference to the circumstances under which a typical investor is put in a position to

realize a stock market or real estate profit (or loss). The White Paper leaves the erroneous impression that the 'well-to-do' (a term which is not defined) represents the typical investor.

CAODC believes that the typical investor may have:

(i) invested all or a portion of his savings in a new issue of a public company or a privately-owned business, thereby running the risk of losing all or part of his investment, or

(ii) over a lengthy period invested a portion of his annual savings in shares of Canadian and other companies, some of which have increased in value over time.

The typical investor undoubtedly made personal sacrifices in order to accumulate savings for investment in stock market or real estate opportunities. Conversely, the neighbour who did not realize such gains may have used up all his discretionary income in expensive holidays in distant lands, or in purchase of expensive cars, etcetera, which are of little value to the Canadian economy.

Securities or real estate investments do not represent the only types of risk-taking investments. For example, the shareholders of an oilwell drilling or servicing company take substantial personal financial risks (perhaps in the form of personal guarantees) each time they buy equipment on a long-term basis from suppliers or

on bank credit. Any appreciation in the value of his investment develops over a long period of time, during which levels of drilling activity can change considerably.

A fair tax system must give recognition to risk-taking, personal sacrifice and hard work by owners. The White Paper ignores the fact that entrepeneurs build a country and its economy.

The hypothetical example alludes to 'substantial' profits or gain. CAODC is of the opinion that, although some investors periodically realize windfall gains, appreciation in value on typical investments are considerably less than 'substantial' and are realized only after a lengthy period of commitment. Certainly this is true of realized gains on sales of oilwell drilling and servicing company investments.

The beginning of the paragraph 1.12 recognizes that increased taxes on higher income taxpayers could not possibly pay the cost of any substantial tax reduction for low-income Canadians. The naivity of the White Paper philosophy is evident from the concluding sentence of the paragraph, which suggests:

> "The way to obtain more revenue above this level is to tax capital gains, close the loopholes, and encourage people to work and invest by avoiding excessive rates on incomes in the highest brackets." (1.22)

It is truly difficult to comprehend how people will work harder and run the risks inherent in most investments if faced with the capital gains tax proposal outlined in the White Paper and the estate tax amendments introduced last year, irrespective of the removal of excessive rates on the highest income brackets.

These and other obvious intentions of the White Paper proposals to redistribute existing and future savings of Canadians and, at the same time, to significantly increase the relative importance of the public sector of the Canadian economy, reflect a political philosophy which has not been supported by the majority of federal and provincial voters, as evidenced by the relative strength of various political parties in the federal Parliament and provincial legislatures. At the same time, the obvious dis-incentive reflected in many of the White Paper proposals seems contrary to established and long-standing federal government policies designed as incentives to assist Canadians at large to improve their lot. Such policies include those related to education and re-training of the labor force, and government financial and technical assistance (in the form of research and development, plant location, assistance and trade promotion) to Canadian companies.

CAODC strongly believes that, without realistic incentives for Canadians to save and invest, it will be difficult for Canada to achieve the second goal of the White Paper which is so important to all Canadians, namely "steady economic growth and continuing prosperity."

Section V

CAPITAL GAINS AS INCOME

The White Paper suggests that introduction of a capital gains tax should remove some of the uncertainty which exists under the present Act as to whether a particular transaction is taxable income or a tax-exempt gain (3.11 and 3.12). The White Paper does not hold that:

> "... the distinction between so-called "capital gain" and an income receipt is either great enough or clear enough to warrant the tremendous difference between being completely exempt and being complete taxable." (3.3)

The CAODC reaction to the White Paper's basis for a capital gains tax and to the specific proposal for such a tax is summarized below.

1. The White Paper states that:

> "The exemption for capital gains has also encouraged taxpayers to make determined and persistent efforts to receive their income in that form, since then it would not bear tax. This tendency was well illustrated by the rash of "surplus-stripping" in the late 1950s and early 1960s." (3.10)

CAODC believes that existing tax legislation provides the Tax Department with the power, which it has exercised, to

stop 'surplus-stripping'. At the time of the appointment of the Royal Commission on Taxation, surplus-stripping was very much in evidence. Since the Royal Commission Report was published in 1967, tax decisions have been handed down by the courts which show that surplus-stripping had been effectively stopped without any change in legislation. In addition, in a speech at the recent Canadian Tax Foundation Conference in Montreal, Mr. John G. McDonald, Q.C., stated: "Section 138A, for example, has put an end to dividend stripping . . .." 1/ In view of this, introduction of a capital gains tax on the grounds that it will prevent surplus-stripping is unnecessary.

2. The White Paper also states that under the present taxation system:

> ". . . if the corporation does not distribute the profits, the value of shares in the corporation will almost certainly increase. If a shareholder realizes on his share of that increase by selling his share at a profit, the present system usually classifies that profit as a capital gain and it is tax-exempt." (3.4)

Although this statement is correct, it ignores the fact that retained earnings are subject to the same risks as original equity investment. There is no guarantee that a shareholder

1/ Taxation of Capital Gains by John G. McDonald, Q.C., Owen, Bird & McDonald, Vancouver, B.C.

will realize a gain on his original investment or reinvested earnings. Retained earnings have been a vital source of funds for financing expansion of oilwell drilling and servicing companies. Less than 30 per cent of the Canadian oilwell drilling companies have shares available to the public, either directly or through associated companies. Reinvestment of earnings enabled these companies to grow to a point where they could finance on a public basis.

3. As part of the proposal to tax capital gains, the White Paper suggests that:

> ". . . all or part of capital losses suffered by a taxpayer would be deductible from taxable income and so save the taxpayer tax at his marginal rate." (3.13)

This opportunity is of little or no comfort to major shareholders of oilwell drilling and servicing companies. Contractors are wholly dependent on the income from their respective drilling companies, the stock equity of which represents virtually all of their capital base. Therefore, if capital losses are incurred, it is highly unlikely that they would have other sources of income against which such losses could be applied for tax purposes.

4. Paragraphs 3.15 and 3.16 refer to the proposed 'valuation day', which will be the basis for determining taxation of subsequent realized or deemed capital gains.

Valuation of privately-owned oil-well drilling and servicing companies will be extremely difficult. Realistic valuations must be based on prospective earnings foreseen by the potential buyer and therefore must be designed around the specific nature of a company's operation. In other words, they cannot be standardized. Values based on historical financial statements are virtually meaningless. Valuations based on prospective earnings are costly and time-consuming exercises. They must be undertaken by qualified persons familiar with the oil industry in general and the drilling and servicing industry in particular. Consideration must be given to a variety of factors including expected profitability of the company; the location, capacity and condition of the assets; capability and availability of management and staff; and, how eager the respective parties are to buy or to sell.

The White Paper admits that if its proposals are implemented, petroleum exploration and development activity will be cur-

tailed. In that event, the value of oilwell drilling and servicing companies will decline substantially.

5. Paragraphs 3.33 to 3.38 inclusive outline a proposal whereby shareholders of widely-held companies (WHCs) would be required to revalue these shares to market value every five years and take one-half of the resulting 'deemed' gain or loss into account for tax purposes in that year. 2/

This totally unrealistic proposal, if implemented, could place a shareholder of a widely-held company in a very serious and unfair tax position, possibly leaving him with one alternative; that is, to sell a sufficient number of shares to meet the tax liability. Successive five-year revaluations could result in majority shareholders losing control of companies which they have built up, which would be unnecessary and regrettable.

The uncertainties as to tax liability under a deemed realization proposal, if implemented, will surely decrease investor interest in buying shares of widely-held corporations which experience a wide range of earnings or market values per share.

2/ A brief supplementary paper, No. 70-31, released on March 10, 1970, by the Department of Finance, discusses problems identified with the proposal, a number of suggestions that have been suggested, and implications of modifying the proposal.

Under a 'deemed realization' tax reform, closely-held oilwell drilling or servicing companies would likely find it increasingly difficult to obtain outside equity capital for financing northern or offshore operations on a public basis.

6. In connection with a capital gains tax at the time of death, the White Paper proposes that:

> ". . . capital gains not be accrued at the time of death but that the person who inherits the assets be treated as if he had purchased them at their cost to the deceased. This cost would be increased by part of the death taxes paid on the assets in question - the part that relates to the capital gain. In this way, there would not be a capital gains tax unless or until the executor or beneficiary disposes of the asset." (3.42)

This proposal overlooks the fact that, in most cases, disposal of assets will be necessary in a relatively short time after death in order to meet estate taxes. In the case of an oilwell drilling or servicing company very few investors want to hold a minority share position. Therefore, the executors of the estate which included such a company, would likely find it necessary to sell all the assets or shares of the company to meet estate taxes. Under the White Paper proposals, if implemented, the beneficiaries would also face a sizeable capital gains tax at progressive rates.

7. Paragraph 3.55 deals with estimated government revenues as a result of implementation of a capital gains tax. In the United States, where a capital gains tax has been in effect for a number of years, such taxes only raise between 5 1/2 per cent and 7 per cent of total personal income tax. The White Paper is looking to capital gains taxes of 5 per cent of personal income taxes, which may be high at least in the early years.

In view of the relatively minor share of total government revenues to be provided by such a tax, coupled with the administrative and other problems it would create, CAODC questions that such a tax can be justified in Canada. Introduction of such a tax may well reduce capital investment and therefore economic growth. Thus, the loss of tax revenues from all sources due to this reduced economic growth could easily offset the gain in revenues from a capital gains tax.

There is no evidence in the White Paper that the 5% yield was determined as a result of a comprehensive analytical study. On the contrary, it would appear that the yield was selected based on the lower level of U.S. experience. If this impression is correct, it is certainly regrettable. Implementa-

tion of a capital gains tax will represent a major shift in the philosophy of investment incentives in Canada. A Canadian capital gains tax should not be based solely on the U.S. experience and should only be presented as a proposal after careful and deliberate consideration of its impact on the economy and government revenues.

8. The White Paper proposes that, in the case of a taxpayer's principal residence, capital gains in excess of $1,000 per year of occupancy on its sale would be taxed subject to certain rollover provisions and on additional allowances for up-keep (3.19).

CAODC is sincerely concerned about the adverse effect which this proposal could have on the well-being of its employees. Presumably, like most other Canadian taxpayers, many hourly-rated or salaried employees of the drilling industry have prudently channelled discretionary income into their homes, with the specific objective of selling the home at retirement and moving into rental accommodation or even purchasing a smaller home, perhaps in locations with less severe climates. In effect, therefore, funds realized on the sale of their residence is a pension. 'Roll-over' provisions would be of little or no benefit to them.

The White Paper proposal may force these employees to continue ownership in order to avoid punitive capital gains tax. In other words, it works against their freedom of choice of geographic location of residence (e.g., Regina or Victoria) and mode of living (e.g., home owner versus tenant). This proposal could be particularly onerous for young married employees who buy a home early in their careers and diligently pay off the mortgage only to face a substantial capital gains tax on sale of their home at the time of retirement.

A flat rate allowance of $1,000 per year is unrealistic, as is clearly evident by calculating the tax exposure of a taxpayer owning a $15,000 house versus one owning a $25,000 house on valuation day, and assuming inflationary tendencies continue. This proposal ignores many factors, including differential housing costs across the country (e.g., Metropolitan Toronto versus Montreal), and the fact that housing needs differ between taxpayers because of size, age, and make-up of families, etcetera.

As indicated in paragraph 3.6, home ownership is a part of the Canadian way of life. Therefore, for this reason and for other indicated above, gains on the sale of principal residences

should be exempt from taxation. 3/

9. The White Paper proposes that capital gains:

> ". . . be subjected to a progressive tax as part of the general income tax system. . . . (and) all or part of the gain would be included in income and taxed at the taxpayer's marginal rate." (3.13)

This proposal seems unduly severe, especially when coupled with recently enacted amendments to the Estate Tax Act.

CAODC adheres to the position taken in its 1967 brief to the then Minister of Finance in response to the Royal Commission on Taxation, that is, since investment of savings in Canada must be encouraged, the taxing of all capital gains should be rejected. If a capital gains tax is necessary in order to remove uncertainties as to definition of income or gain, then certainly it should be at a fixed rate independent

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3/ News Release No. 70-33 by the Department of Finance, dated March 16, 1970, deals with Tax Reform and the Home-Owners. CAODC finds a number of the statements in this Release to be unacceptable. For example, it suggests that some of the gains can result quite fortuitously as a result of re-zoning. CAODC believes this statement is misleading. Such gains are probably the exception, not the rule.

The Release also says that the Department wishes to exclude most Canadian homes from any capital gains tax at all. This objective is not likely to be achieved under the proposal as presently structured.

of the progressive and marginal rates of the taxpayer and should relate only to realized gains. Also, if Canadians are to be encouraged to invest in the development of the country, the rate should be significantly lower than the rate applicable in the U.S.

10. Paragraph 1.28 states that:

> "The economic effects of taxing gains have been appraised and are considered unlikely to interfere significantly with incentives to save and invest in Canada."

Once again there is no documentation currently available to support this major tax reform proposal. Because of the importance of savings and investment to the Canadian economy, this appraisal should have been detailed in the White Paper. If such an appraisal was not undertaken on a comprehensive basis, the White Paper justification for taxing capital gains should be discounted.

Section VI

CORPORATIONS AND THEIR SHAREHOLDERS

Paragraph 4.18 suggests that the present Income Tax Act has a number of shortcomings relating to taxation of corporations and their shareholders. For example, paragraph 4.18 (3) indicates that an incorporated taxpayer has a tax advantage over one who cannot incorporate.

Although this is true, certain other factors are relevant. First, certain classes of taxpayers are not permitted to have limited liability, and therefore, are unable to incorporate, e.g., lawyers, doctors, accountants.

Also, many partnerships or proprietorships, for example small stores or retail services, have very low profit levels after providing for a reasonable level of proprietor or partnership withdrawals. Some such operations have little growth potential.

Conversely, many small incorporated companies have high growth potential. The 21 per cent corporate tax rate up to $35,000 taxable income provides them with an important internal source of funds which would not be available if a single 50 per cent tax rate

applied. Many small companies have difficulty financing through conventional sources. As they grow, the combined corporate taxes and personal income taxes paid by owners and employees will likely far exceed taxes paid by the proprietorships and partnerships referred to above.

In fact the 21 per cent tax rate on the first $35,000 taxable income was introduced on purpose to provide small companies with an opportunity to grow. The United States has a similar provision which has not caused any serious troubles regarding associated companies. In the United States if two associated companies have different business purposes then each is eligible for the low rate of tax.

These alleged shortcomings of the present Act presumably serve as the justification for the subsequent proposal to create one set of rules for closely-held corporations - the incorporated proprietorship and partnership - (CHCs), and another set for widely-held public corporations (WHCs).

The distinction between CHCs and WHCs reflects the White Paper's opinion that:

"by and large, the closely-held corporation competes with proprietorships, partnerships and of course with other closely-held corporations, while the public corporation competes with other public corporations, both Canadian and foreign." (4.19) 1/

The White Paper also deals with this matter of competition in paragraphs 1.40 and 1.42 when it states that "(CHCs) usually compete in markets with unincorporated businesses subject only to personal income tax" and "products or services (of WHCs) are usually sold in competition with other large corporations where prices yield an adequate rate of return after paying corporate tax."

CAODC disagrees with these White Paper views on competition. In almost every type of industrial class of business, CHCs compete with WHCs. Taxation Statistics 2/ identifies nine major industrial classes, which are subdivided into about 140 sub-classes. Only a dozen of these sub-classes are largely restricted to competitions between WHCs, that is pulp and paper mills, iron and steel mills, aircraft manufacture, automobile manufacture, appliance manufacture, petroleum refineries, railways, pipelines, electric, gas and telephone utilities, and commercial banks.

1/ See also paragraph 4.34.

2/ Published by the Department of National Revenue, Taxation Division.

Certainly the corner grocer competes with Loblaws; the small British Columbia sawmill competes with MacMillan Bloedel Limited; the independent oil producer competes with Imperial Oil Limited; etcetera. In the oilwell drilling and servicing industry there are 13 widely held corporations and 30 closely held corporations. There is no doubt that they compete actively and strongly with each other.

The objective of the tax reform proposal for CHCs is to put them as nearly as possible in the same position as their competitors (4.20). However, since the fundamental White Paper assumption as to the typical competition for CHCs and for WHCs seems wrong, then the specific tax proposals based on such errors must be rejected. The White Paper proposals have followed certain suggestions made by the Royal Commission on Taxation which are fundamentally different from the present Income Tax Act. The key suggestion is that integration of corporate and personal tax be achieved by the use of creditable tax given to the individual, based to some extent on the taxes paid by the corporation which declares the dividend.

The present Income Tax Act gives a form of integration that the shareholders of a Canadian corporation can claim a credit

of 20 per cent of his taxable dividends against his income tax. The tax credit method was instituted in Canada some years ago and while it has some shortcomings it is generally understood by the average taxpayer and certainly has been easy to apply.

The creditable tax system proposed in the White Paper is similar to the system that was used in the British Isles for a great many years but was changed there in 1966. On the surface this appears to represent a sound basis of taxation because double taxation is said to be eliminated, which is high desirable.

The more the double taxation is eliminated the less the net revenue to the Government from taxes. Additional and other taxes must be levied to make up for such deficiency. This of course was recognized in the White Paper and presumably these additional taxes are proposed to come from a new tax on capital gains, heavier tax rates on middle bracket taxpayers, etcetera.

Another solution for the small companies set forth in the White Paper is that they can elect to be taxed as a partnership. This suggestion has some merit and of course has met with some success in the United States. However, the White Paper is throwing up a number of additional regulations with which a corpora-

tion must comply in order to be able to make such an election.

The concept of distinguishing between CHCs and WHCs for tax purposes raises a number of other problems or contradictory statements including:

1. Regarding CHCs, cash or stock dividends paid out of profits retained beyond 2 1/2 years from the end of the corporation's taxation year will bear full personal income tax rather than be creditable against shareholder taxes. The White Paper states that, without this limitation, corporations could accumulate creditable tax for 10 to 15 years and then pay large dividends, thereby seriously affecting government revenues in the year of distribution.

Arising from this is another series of regulations. Since it is obvious that most corporations, if they are to be successful and promote the growth of Canada, cannot pay out their earnings this quickly over a long period of years, the idea was conceived that a stock dividend could take its place. Again this sounds like a new simple solution but it will result in creation of very combersome capital stock structures.

In addition, it could require renegotiation of long-term debt instruments which have restrictions on dividend payments. Such renegotiations could result in higher interest rates. Also, because the profits would be paid out in order for shareholders to be eligible for creditable tax, financing growth of small companies would be more difficult.

2. Also arising from the new method of integration are a number of anomalies as to whether or not taxpayers will actually obtain creditable tax on dividends which they receive from Canadian companies. There are timing differences which occur when certain expenses are permitted to be deducted from taxable income within a taxation year whereas for accounting and financial purposes these expenses are amortized over a period of years. Depreciation and pre-production expenses of mining and oil companies are two of the major items in this regard though there are a number of other revenues and expenses which are treated differently for tax and accounting purposes. Since the accounting method shows a profit, the company can legally pay dividends out of profits if it wishes to do so.

Western Canada has a comparatively large proportion of companies in this category because the western economy (other than agriculture) has a greater proportion of mining, petroleum pipeline and utility companies than do other areas of Canada who in their case rely more heavily on commercial and manufacturing industry.

Many of these Western Canadian companies are paying dividends but are not paying tax. To the extent taxes are reduced today because of these other charges, at some time in the future these companies will pay higher rates of tax because these deductions can only be taken once. If taken in large bites in the early years only a small bite will be on hand for tax deduction purposes in the later years.

However, in the meantime shareholders of these companies will either earn no creditable tax on dividends they receive or the creditable tax will be minimal. While this situation is in existence, the Canadian investor will obtain a better net return on his investment if he buys shares of companies who are currently paying tax as opposed to buying shares of companies who are paying little or no tax. This may result in the Canadian

investor switching his investments away from natural resource companies, drilling companies and pipeline companies.

To avoid such a switch these latter companies will have to substantially increase their dividend rate to attract equity investment. As the dividend rate of return increases to attract the Canadian investor the foreign investor will also be attracted. The foreign investors basic tax position has not changed since he will still normally be subjected only to the 15 per cent withholding tax imposed by Canada, particularly if the investor lives in a treaty country. In most cases he recovers the 15 per cent withholding tax from the tax of his own country so that his net taxable position is unchanged. This therefore makes it very attractive to him when the dividend rate on these affected Canadian companies rises above a rate that he can comparatively earn in his own country.

The White Paper itself has stated that it wishes to have Canadians invest in Canada and that it would like to see Canadians own as much as possible of their own industry. The result of this integration proposal in the White Paper would then appear to make it even more attractive for non-Canadians to gradually

acquire the shares of our natural resource, pipeline, utility, or drilling companies.

3. The differential tax position on dividends paid by CHCs and WHCs or on the sale of shares of CHCs and WHCs most certainly complicate financing growth and expansion of small businesses.

A CHC shareholder will receive creditable tax on the full dividend received. WHC shareholders will receive only creditable tax on one half of the dividend received.

4. The White Paper purports to be proposing tax methods that will be simple and easier to understand than the present Income Tax Act. CAODC feels however, that the authors of the White Paper have underestimated the complexity which will exist where CHC's are controlled by WHC's and vice versa and where there are a series of three or more corporations which are not all in one category or the other.

Ours is a complex business world. Therefore the Tax Department will face many exceptions to the rule. Once a corporation closes its books at the end of a fiscal year and files its tax

return one might suppose that it could then tell its shareholders the rate of tax that would be creditable on their dividends. However, there are many instances when the return filed by a corporation is not in agreement with departmental thinking. In those cases where the departmental thinking proves to be correct adjustments are made in the taxes payable. This could happen any time up to 10 years and this in turn changes the creditable tax on a retroactive basis.

On March 19 Mr. Benson issued a technical paper explaining the mechanism to give shareholders credit for corporate tax paid under the proposed system of tax integration. As usual the figures incorporated therein are said to be on as simple a basis as possible but even this simple basis is difficult to understand. When one gets into the greater complexities of actual business life one will find that this can become a considerable headache.

CAODC agrees that if one enters into this field of creditable tax as the basis of integration it would be most difficult to continue to carry two tax rates for corporations. The present system of a 20 per cent tax credit is roughly aligned with the 21 per cent rate on the first $35,000 of income. CAODC suggests

that the present tax credit system be continued, that the dividend tax credit be increased to 25 or 30 per cent, and that the low rate of tax be similarly increased or possibly by a slightly greater amount. This would avoid the tremendous complexities which will arise out of the creditable tax proposals and will leave the Canadian taxpayer in a position where he can clearly understand what is happening to him. There would be a greater advantage than at present for Canadians to invest in Canadian companies but it would not discriminate between resource companies on the one hand and industrial and manufacturing companies on the other nor would it discriminate between public and private companies.

Section VII

BUSINESS AND PROPERTY INCOME

The White Paper tax reform proposals provide for certain changes in the present tax system as it relates to business and property income. Specific proposals of particular interest to CAODC members are treatment of goodwill; entertainment and related expenses; and, mining and petroleum. CAODC's views on proposed treatment of the petroleum industry are considered in a later section of this brief.

A. GOODWILL

The White Paper proposes to create a new depreciation class which would enable the taxpayer to deduct 10 per cent of the book value of 'nothings' such as goodwill each year. The White Paper points out that it would be impossible, without a tax on capital gains, to permit this type of write-off. The White Paper states:

> "For as long as the proceeds of the sale of goodwill . . . remained tax-free, it was impossible to give a deduction for the cost of purchasing goodwill without creating a leak in the tax system." (5.6)

The White Paper points out that (i) the goodwill that a company has five years from now will be the result in part of its past actions and in part of its actions in the next five years; and, (ii) purchasers would be willing to pay more for goodwill under the proposed tax system than they are willing to pay under the existing system. For these reasons, the White Paper proposes that taxpayers who sell goodwill in the first year of the new system would be taxable on 40 per cent of the proceeds. The taxable portion would increase by 5 percentage points each year until the 13th year when 100 per cent of the proceeds would be taxable.

CAODC believes that this proposal to tax 40 per cent of goodwill in year one would be, in effect, retroactive taxation and therefore conflicts with paragraph 1.12 which states:

> ". . . Individuals and businesses must be able to plan their affairs sensibly, particularly in making investments that yield a return for many years. This need for stability also implies that reforms should not include retroactive changes, applying to incomes earned in previous years. The government's proposals provide that the changes in rules would apply only to periods after publication of the proposals. In particular, they will not bring into tax capital gains earned before a future date to be announced."

The large investments and personal financial commitments of drilling companies and their shareholders were made in good faith in reliance upon the established tax system. Investor confidence

will be seriously impaired if White Paper proposals have a retroactive effect.

B. ENTERTAINMENT AND RELATED EXPENSES

The White Paper proposes to set more rigorous limits to check "expense account living". Specifically, the costs of attending conventions and belonging to social and recreational clubs would not be permitted (2.11, 1.35, 5.9). Also,

> ". . . The costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded. Owners or employees of a business having a car or aircraft available to them for their personal use, including to and from home, would have to pay the business a minimum stand-by charge, or have a corresponding amount added to their personal income for tax purposes."

CAODC supports the position that flagrant misuse of expense allowances is unjustified. However, the authority to disallow inappropriate costs is contained in the Present Act, and, indeed, the Tax Department is scrutinizing such expenditures very carefully.

Also, CAODC believes the government should be aware that legitimate promotional costs which are appropriate for one industry may be entirely inappropriate for a different industry, and

vice versa. For example, magazine, newspaper, TV and radio advertising may be appropriate promotional media for the automobile industry. However, use of such media by the oilwell drilling and servicing industry on a large scale would be inappropriate, wasteful and costly. Alternatively, attendance at petroleum industry conventions and personal meetings with customers is an effective promotional technique because of the highly personalized nature of the drilling and services industry. This is particularly important since it gives the contractor an opportunity to develop an understanding of the specific drilling or servicing requirements of individual oil companies.

Also, the majority of people who are exposed to radio, television or newspaper advertising used by many consumer durable goods are not potential buyers. Conversely, all of the advertising and promotional costs of drilling and servicing contractors is directed at prospective or existing customers.

The blanket White Paper proposal relating to "expense account living" clearly illustrates one of the worst dangers of legislation that is, dealing too minutely. This creates a degree of inflexibility which is inconsistent with the dynamic nature of our economy. Unless legislation makes certain exclusions which are justified, it can create hardships for certain taxpayers.

Section VIII

IMPACT ON THE ECONOMY AND GOVERNMENT REVENUES

The second goal and standard which guided the authors of the White Paper in their approach to tax reform was ". . . steady economic growth and continuing prosperity . . .." (1.6) The White Paper goes on to point out that:

> "The second main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity. Taxes by their nature cannot always promote all our economic goals, but they should interfere as little as possible with incentives to work and invest and with the directions our economy follows in meeting demands of consumers and foreign markets. Some proposals in this paper are intended to ensure that the incentive to work and invest is not unduly inhibited and that investments needed for productivity and public purposes are not rejected in favour of less desirable alternatives just because of their tax consequences." (1.10)

A. IMPACT ON NEW INVESTMENT

A number of authorities have expressed concern that implementation of certain White Paper proposals will discourage investment of new domestic and foreign capital in Canada. Mr. W. Earle McLaughlin, Chairman and President of the Royal Bank of Canada, made the following disturbing comment about international

capital in an address to shareholders on January 8, 1970:

> "It is of course too soon to evaluate all the effects of markets and on the supply of foreign capital. We do know, however, from our sources of information as international bankers, that the initial reaction to the White Paper on the part of existing and potential foreign investors is one of uncertainty and hesitation - both unfavourable effects."

Mr. N.J. McKinnon, Chairman, Canadian Imperial Bank of Commerce, expressed similar views in an address to shareholders on December 9, 1969:

> ". . . there is a world-wide shortage of capital for investment which is likely to continue for a long time. Canada is and has been for years in chronic need of more capital for investment. . . . Without this continuing (foreign) capital investment the nation could not have grown in Gross National Product and in employment to anything like the extent it has. This growth has been encouraged by tax incentives designed to stimulate rapid development of our natural resources. This in turn has created rapidly growing markets for secondary businesses. . . . The authors of the White Paper seem to have overlooked that new investment capital is fluid and is extremely sensitive to the environment provided by the host country. No one, neither non-resident nor resident, needs to invest in Canada. Raw materials are being found in all parts of the world and capital will go the most attractive environment. The principal reason why Canada has been an attractive place to invest has been its system of taxation which, though far from perfect, has created the incentives and the consistencies of treatment to induce both domestic and external capital to invest in this country. Unquestionably, there will be profound changes in the attitude of foreign

capital to investment in Canada as a result not only of the immediate taxation measures proposed in the White Paper but in their longer range implications for the development of the economy and the capacity of the country to service foreign investment."

Mr. H.C. Van Rensselaer, Vice-President Finance, Bow Valley Industries Ltd., held discussions in late 1969 with representatives of about 40 leading United States financial institutions. They all agreed that the White Paper proposals, if enacted, would make Canada a far less interesting place for investment than at present, and particularly would make natural resource companies less attractive for investment.

CAODC agrees with an earlier statement in the White Paper which recognizes that for the foreseeable future Canada's capital requirements will continue to exceed available domestic savings (6.8), and that:

"Moreover, it is in Canada's interest as a substantial capital-importing nation to maintain an international climate hospitable to the unrestricted flow of capital across international boundaries." (6.9)

The exploration and development phase of the Canadian petroleum industry has an enormous and rapidly-growing need for capital. For example, in 1968 net cash expenditures of the industry

in Western Canada exceeded $1.2 billion. These expenditures exclude sizeable investments related to other phases of the industry, such as pipeline and refinery construction. Recent estimates suggest that capital requirements for exploration and development activities in Canada will exceed $20 billion in the 1970s if the petroleum industry is to be able to meet market requirements for Canadian oil and gas. Raising these amounts of risks capital in light of a worldwide shortage of capital will be a challenging task and will require a stable and attractive climate for domestic and foreign capital. This investment climate must be as good or better than that available in other countries. We are competing with other countries for the same investment dollars.

The White Paper recognizes that its proposals would adversely affect the after-tax rate of return of, new investment in, and capital expenditures by, the petroleum industry, as indicated below:

> "Implementation of the proposals for the corporate taxation of companies in the mineral industries would presumably be reflected after some years in the after-tax rate of return of those companies and their shareholders, particularly if the company does not carry on enough exploration or development work to earn a depletion allowance on its producing properties." (8.46)

> "On the whole these changes affecting non-residents are not expected to cause any substantial reduction in foreign investments in Canada, although some decline must be expected in foreign investment in the mineral industries and in small closely-held corporations." (8.47)

> "The changes proposed . . . would have some effect in reducing the expected rate of return both from new mining projects and new oil and gas projects." (8.48)

> "The general economic effects of these proposed tax changes would include . . . probably some reduction in the capital expenditures of closely-held corporations and the mineral industries." (8.49)

Oilwell drilling and servicing companies are completely dependent for their livelihood on petroleum exploration and development. Thus, they are quite legitimately concerned about the possibility of adverse effects of the White Paper proposals on future investment in the petroleum industry. Tax policies designed to reduce investment at a time when future requirements for capital will be extremely large seems imprudent. CAODC is also alarmed with the White Paper's prediction of adverse impacts of its tax proposals on closely-held companies. The majority of CAODC member companies and many of their customers are closely-held companies.

B. EMIGRATION OF PROFESSIONAL AND TECHINCAL PERSONNEL

A second economic issue referred to in the White Paper is:

> ". . . to what extent Canadian income taxes affect the ability of Canada to retain able and highly trained Canadians who could emigrate to the U.S., and to attract skilled and able persons from the U.S. or elsewhere." (8.38)

By reference, the White Paper seems to support the position of the Royal Commission on Taxation, which expressed skepticism that tax factors have been a major factor in emigration. The White Paper also suggests that, since publication of the Carter report, changes in conditions in the U.S.:

> ". . . have made that country less attractive to Canadians considering emigration and changes in its immigration laws have made it more difficult for Canadians to emigrate to the U.S." (8.38)

Prime Minister Trudeau also referred to the subject of emigration in a recent speech in Toronto when he commented: 1/

> "Of all the wild charges about the White Paper we have heard I am least impressed by the claim that it would cause a massive wave of emigration to the United States. People who talk in this way are exaggerating the effects of our proposals, but they also misunderstand the nature of our attachment to this country."

While these statements may be true in regard to untrained persons (who normally are low wage-earners) CAODC does not believe they are true in regard to well-trained and educated persons

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1/ Address to the Toronto and District Liberal Association, March 4, 1970, Royal York Hotel.

who have the ability to understand tax levels in different countries and who also have the skills which will provide them with employment in countries other than Canada.

CAODC is of the opinion that if the White Paper proposals are implemented, tax factors will become a more significant factor in emigration. The White Paper is quite misleading when it refers to the fact that the new basic exemption for Canadian taxpayers would be much higher than those in other countries (paragraph 1.25 and table 3). A Canadian considering emigration will look at the differential between his net take home pay in Canada versus what it would be, for the same type of employment, in another country. This differential would be based on (i) variations in gross incomes, and, (ii) variations in <u>total</u> not just <u>basic</u> exemptions allowed. If the White Paper proposals are implemented and they have the effect of widening the disparity in net earnings that a Canadian can earn in Canada versus in some other country, then certainly this will carry more weight in his decision as to whether or not to emigrate.

Under the White Paper proposals, a single taxpayer (with no dependants) earning $10,000 per year would pay $252. or 11.3 per cent more tax than under the present system. In addition to

the increased personal taxes, other forms of tax, such as the punitive capital gains tax, the amended estate taxes, etcetera, will tend to influence skilled Canadians to emigrate. It is the well-educated single taxpayer, because of his relative mobility and low capital base, who is likely to emigrate, which would be a tragedy. At the same time, implementation of these proposals will make it unattractive for Canadians (such as drilling and servicing company personnel) to accept short-term foreign assignments which contributes to Canada's export business. It would be unattractive because of the deemed realization provisions of the White Paper.

On a total national basis, emigration may not be influenced significantly by implementation of the White Paper proposals. However, on a regional basis - particularly in Western Canada - it could be much more of a problem because of the nature of the petroleum industry.

That industry is international in scope. Therefore, Canadians considering emigration can look beyond emigration to the United States. In other words, the White Paper reference to changing conditions and immigration laws in the U.S. is not entirely relevant. Petroleum industry personnel (including professional and skilled technicians in oilwell drilling and servicing) in Canada can find

challenging opportunities in other parts of the world, including the Middle East, Australia, and North Africa. Drilling supervisors accepting positions in foreign countries receive very high salaries, in many cases tax free, plus other benefits such as paid transportation home every two years. It has been estimated by CAODC that, in the past seven years, over 1,000 Canadian drilling supervisors have accepted foreign assignments. This indicates the demand for this type of skilled Canadian personnel. As a result of this situation, it has been necessary to train about three times the number of supervisors required for the Canadian industry.

As indicated earlier, implementation of the White Paper proposals would lead to a reduction of new capital investment in the petroleum industry. The effect of this development would be decreased employment. Many petroleum industry employees are university-trained or technically-trained specialists. According to one source, 42 per cent of all the geologists in Canada are employed in Alberta. 2/ In addition the industry employs a large number of lawyers, chartered accountants and economists in specialized petroleum

2/ Oil Companies by A.H. Ross, Vice President and General Manager, Western Decalta Petroleum Limited, in a paper presented to the January 30, 1970 seminar on "Proposals for Tax Reform", sponsored by the Calgary Chamber of Commerce.

assignments. Because of a turn-down in activity, such specialists let out of work, and new graduates unable to find employment, would tend to emigrate. Their specialized training and interests could prevent them from finding suitable alternative employment in Canada.

The growth of the petroleum industry in Western Canada reversed the emigration of Canadians to other countries and, to a certain extent, the rural to urban shift of our population. For example, the oilwell drilling and contracting industry has provided thousands of full-time or part-time employment opportunities, particularly for farm and other rural residents. Because of the seasonal nature of the drilling industry, many drilling and servicing industry employees have been able to continue operating farms. Drilling operations are reduced substantially during the spring, summer and fall when the farmer is very busy. Conversely, drilling operations accelerate in the winter which is the off-season for farming operations.

(In this regard, it should be pointed out that in recognition of the need to improve employee skills and in anticipation of drilling activity in the far North, the Association in co-operation

with the Alberta Government established an oilwell drilling training school in early 1967 in Edmonton. Since that time, in excess of 2,500 employees from across Canada have received basic and higher training in drilling technology).

The oilwell drilling and servicing industry has created business opportunities in many small communities adjacent to drilling operations. This phase of the petroleum industry alone purchases close to $25 million of goods and services in Canada annually. A typical oilwell, requiring about 20 days to drill, would cost about $125,000. Only about 31 per cent or $39,000 of this amount would be revenue to the drilling contractor. About $16,000 of the contractor's share would go to taxable wages and salaries and the remaining $23,000 would go to repairs and maintenance costs, supplies, depreciation, risk and profit.

The remaining $84,000 would be allocated out as follows:

Land 'Acquisition' (from government)	$23,000
Road Building	4,500
Contract Trucking	4,200
Well Testing	9,400
Production Equipment	42,700
	$83,800

Exploration and development activity until quite recently

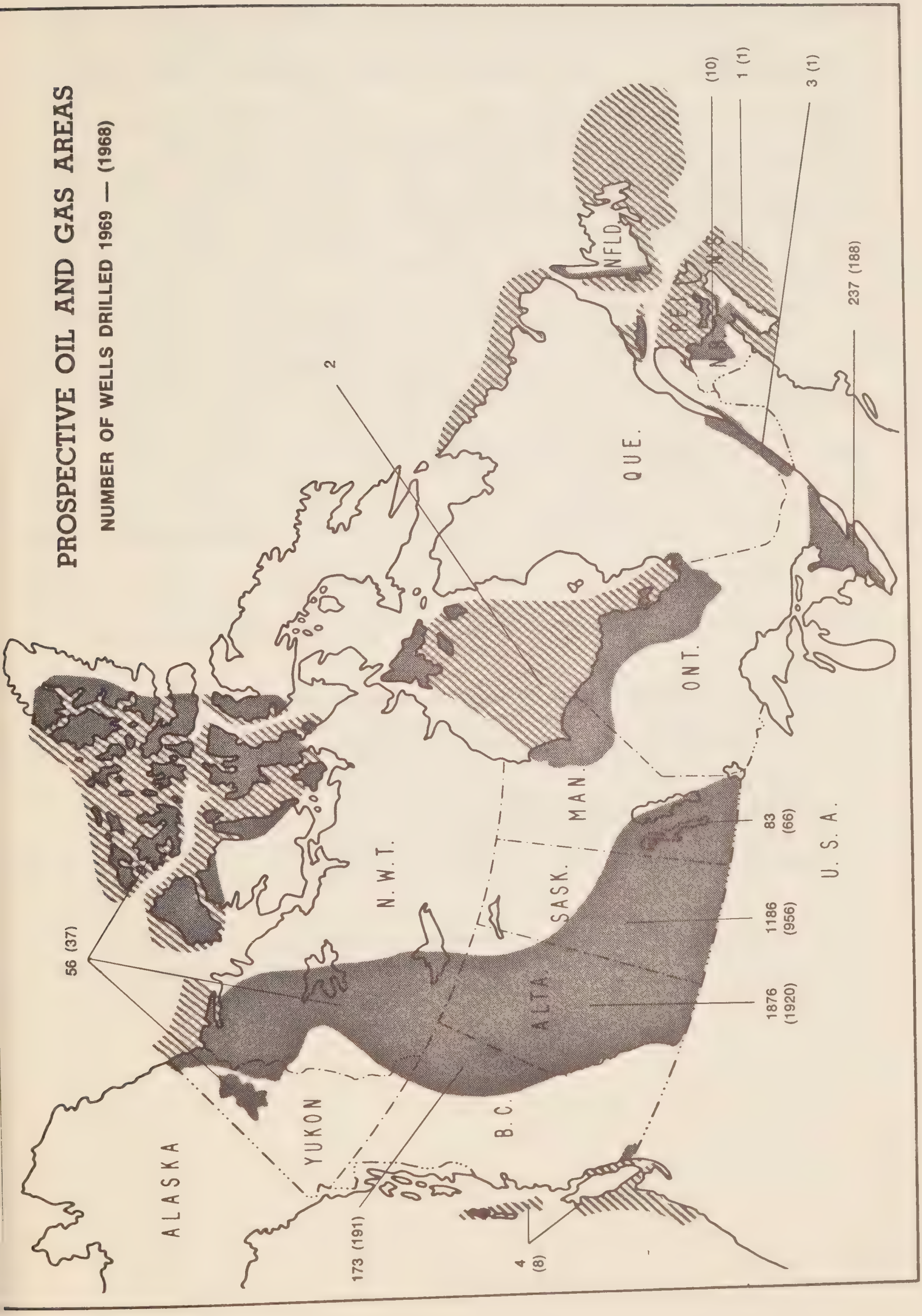
was centred in Western Canada. However, it is expected to become increasingly national in scope. Drilling activity should increase in the pioneer or frontier areas of Canada (the West Coast, Mackenzie Delta, the Arctic Islands and Offshore Hudson's Bay, Gulf of St. Lawrence and Gaspé). This will provide employment and business opportunities in these areas, assuming of course that our tax laws encourage continued investment in the industry.

The White Paper did recognize that, under its proposals, married taxpayers at higher income levels would pay somewhat more tax in Canada than in the U.S. The White Paper suggested that these differences:

> ". . . could best be met in the market by adjusting the pay scales for those individuals or scarce categories who must be retained or attracted against U.S. competition." (8.39)

This suggestion seems inappropriate and an over-simplification because, if followed, it could precipitate an upward restructuring of several categories in the overall wage and salary structure that is now in effect, with a resulting inflationary effect on the economy and subsequent efforts by other segments to obtain similar increases.

In summary, CAODC is concerned that the White Paper



PROSPECTIVE OIL AND GAS AREAS

NUMBER OF WELLS DRILLED 1969 — (1968)

may have under-estimated the extent to which its application will increase emigration from Canada of highly-skilled or highly-trained people or, alternatively and just as serious, will discourage such persons from moving to Canada from other countries. It is hard to believe that prospective immigrants with these qualifications will come to Canada to live if our tax laws are more severe than those in effect in other countries. It seems ridiculous to spend a sizeable portion of our combined municipal, provincial and federal government budgets on education, training and re-training, and then introduce tax reforms which will prompt Canadians to emigrate.

In connection with its proposal to tax capital gains and, at the same time, to limit personal tax rates to a maximum of 50 per cent, the White Paper states:

> ". . . (when) applied to the earned income of professional workers and executive (it) would lead to some slackening in their efforts and a desire to take benefits in the form of holidays, retirement pay, and other non-productive and less-taxable forms. Canada needs the full effort of those with outstanding ability. It must compete for such people with other countries where able Canadians can go to live and to work if they wish." (2.39)

> "It is very difficult to appraise the effects of these high marginal income tax rates on work effort and on decisions concerning staying in Canada, or moving to

Canada. Many factors enter into such decisions, and income tax rates may well not be the most significant factor." (3.9)

This last quote clearly illustrates one of the basic weaknesses of the White Paper. It appears to be proposing tax legislation on the basis of opinion or judgments which apparently are not based on factual data. Canada cannot afford to run the risk of losing highly-skilled Canadian workers and entrepeneurs through implementation of the White Paper proposals on the basis of such weak statements as "income tax rates may well not be the most significant factor", and "we are skeptical that tax factors have been a major factor in emigration."

C. GOVERNMENT REVENUES

The third goal and standard of tax reform suggested in the White Paper is the recognition of modern social needs.

The White Paper claims to have made a careful assessment to see that the revenues required will be produced. At the same time, however, it makes only a fleeting reference to level of revenues required, as follows:

"The needs of the federal and provincial governments for money to do useful and important things are so great that we cannot now afford to reduce the overall revenues from personal and corporate income tax." (1.3)

"Our increasingly urban society imposes upon governments and other public authorities demands and conditions which strain to the limit their ability to finance and to execute their activities. The reformed income tax must further the proper development of this changing society." (1.13)

"New and enlarged government programs in the welfare field have made it necessary to raise substantially more revenue." (2.3)

The White Paper also made the following reference to the substantial increase in public expenditures (federal, provincial and municipal) since 1964:

"These additional expenditures are already providing tangible benefits to taxpayers and improving the economic and social environment in which taxpayers live. They include medicare, housing, youth allowances, student loans, university support, occupational retraining, improved assistance to those in need, and major expenditures on industrial and regional development." (1.17)

This statement is a rather sweeping generalization that may not necessarily be supported by the majority of Canadian taxpayers. At the same time, it is ironical that many of these programs are designed to assist Canadians to improve their livelihood, e.g., student

loans, university support, retraining and industrial development. Yet the tax reform proposals will have the effect of penalizing those Canadians who have the initiative to take advantage of such programs.

All levels of government have an important responsibility to keep their expenditures (including those associated with proposed new social programs) within financial boundaries that can be supported from existing revenue sources. This will require creation of priorities in allocating revenues to existing and proposed programs.

Mr. G. Arnold Hart, Chairman of the Bank of Montreal, made the following comment regarding future spending programs referred to in the White Paper: 3/

> "The White Paper is based on the unsubstantiated assumption that the Government needs more money for programs that the public has not asked for .. . . This assumption is very disturbing for it suggests that the Government knows best how future gains in the income produced in the private sector should be spent, and moreover, knows this in advance before consulting the electorate as to its wishes --- Incredibly, we have a situation where Canadians are being invited to submit to higher taxes, not to pay for programs they have asked for, not even for programs that have been put to them in an election platform, but just because the Government makes a bland assertion that it will need more money and therefore proposes to write itself a blank cheque on the collective bank account."

3/ In a December 1969 speech to shareholders of the Bank of Montreal.

The Honourable J.V. Clyne, Chairman and Chief Executive Officer of MacMillan Bloedel Limited, also commented on these proposed spending programs: 4/

> ". . . I will confine myself to a discussion of the White Paper not so much as a proposal for tax reform but as a document designed to create revenue for a broad undefined scheme of social change in Canada. I believe, on the evidence we have seen, that the White Paper is only part of that scheme and that the great debate on tax reform can reach no real conclusion until the Government has revealed more of its intentions. What programmes has it in mind that would require the vast sums the White Paper would produce? How can those of us outside government be expected to make a qualitative judgment on tax proposals without knowing what projects are planned and what they will cost? It is unprecedented for a government to seek new revenue on this scale without saying where it proposes to use it."

CAODC believes in personal initiative and incentives but disagrees with introduction of social or other programs which have the effect of increasing the relative importance of the public sector's share of total GNP. The sixth annual report of the Economic Council of Canada indicated that the public sector share would increase from 32 per cent in 1968 to 37 per cent in 1975.

4/ "The White Paper -- A Summing Up" - an address to the Canadian Tax Foundation Conference in Montreal by The Honourable J.V. Clyne, Chairman and Chief Executive Officer, MacMillan Bloedel Limited, March 25, 1970.

Recent trends suggest the 37 per cent level will be reached much sooner. In contrast, the public sector in the U.S. accounts for only 31.4 per cent of its total GNP, 4/ even with the sizeable expenditures associated with the Vietnam War and the Space Program. Without these two major expenditures the ratio of the public sector to total GNP in the U.S. might be as low as 25 per cent. CAODC questions why we have to be so far out of line with the U.S. in this regard.

The White Paper recognized that its proposals would increase the relative importance of the public sector, as indicated by the following comment:

> "These (reductions in capital expenditures of CHCs and the mineral industries) would be offset by a small immediate increase in public revenues, and a rather larger increase after the early transitional years. These aggregate changes, however, could be taken into account in the determination of monetary and fiscal policy and could be offset in their general effects on total incomes, employment and prices." (8.49)

In regard to this shift from the private to public sector, CAODC agrees with Mr. Clyne's comments, as follows: 1/

> "Now in Canada, we are asked to accept a system of taxation that would gradually drain off the reservoir of individual private savings to the public sector where

decisions as to its investment would largely be in the hands of civil servants. While their management of investments might be very skillful, we would not expect to get much from them in the way of risk capital, which is precisely the kind that has sparked Canada's development. We must ask ourselves if such a system is one which we desire where initiative is taken from private citizens and given to government. Only when we have answered that question are we ready to write new tax legislation."

"Now there is no doubt that massive amounts of money must be allocated to the relief of suffering wherever it is found in a modern society with humane objectives. But to what level can public sector spending go before the ability of the country to carry on as a healthy economic entity begins to disintegrate? One either has a free competitive system or one has not, and at some point continued enlargement of government participation or intervention in the economy of a country will transform it to one of total state control.

No one can say with assurance how close we are to that point, but I suggest that we will reach it soon unless as much attention is paid to the pace and priorities of government spending as has been given to the revenue side of government activities during the past seven-and-a-half years."

Section IX

CAODC RECOMMENDATION TO THE MINISTER OF FINANCE

Both the Minister of Finance and the Prime Minister have stressed that persons or organizations which are critical of specific White Paper proposals should make alternative recommendations. For example, in his recent Toronto speech, the Prime Minister commented: 1/

> "If they object to specific measures, they should suggest practical alternative methods of achieving the objectives to which they agree."

The purpose of this section is to summarize the overall CAODC recommendation to the Minister of Finance concerning the major proposals for tax reform. However, the section first deals with two related subjects - (1) administrative and judicial problems which would be created if these proposals were implemented; and, (2) the uncertainty associated with forecasting impacts of such proposals on the Canadian economy.

A. ADMINISTRATIVE & JUDICIAL PROBLEMS

The goals and standards which guided the authors of the

1/ See footnote 1, Section VIII

White Paper included:

> "widespread understanding of and voluntary compliance with tax laws combined with enough detail to block loopholes." (1.6)

The White Paper is satisfied that the proposed tax reforms are practical and effective measures, as indicated below:

> "The government's proposals are the result of careful study of tax principles, practices and impact. The government believes they are the best practical proposals to attain our objectives in present circumstances." (1.4)

> "The following proposals are commended to Canadians as practical and effective measures to accomplish the objectives of tax reform." (1.23)

Prime Minister Trudeau supported this position in his recent Toronto speech[1/] when he said:

> "We believe that this is a good White Paper because it sets out clearly many of the problems of our tax system and suggests methods of solving them."

CAODC believes that there are may aspects of the proposed tax reforms which are impractical and will be extremely difficult to administer, either by corporate taxpayers, individual taxpayers, or by federal and provincial governments.

CAODC is also seriously concerned that these overall proposals, if enacted, would cause a lengthy period of uncertainty during which legal interpretation of the new act was tested in

1/ See footnote 1, Section VIII

the courts. This concern is similar to that expressed in the 1967 CAODC brief to the Minister of Finance regarding the Report of the Royal Commission on Taxation, in which CAODC stated:

> "The proposed tax system will require years of training for Revenue Department and private business staffs. It will be costly and difficult to administer. It will also cause many years of uncertainty as to judicial interpretation. This uncertainty will prejudice further investments in Canada as the application and effect of these tax laws will be unknown. The Association submits that the present system of taxation, with which people in this and other countries are familiar, will with necessary modifications from time to time, continue to serve this country admirably."

The White Paper objective to block loopholes is commendable. In fact, may of the types of loopholes referred to throughout the White Paper, wuch as surplus-stripping and associated companies, in the opinion of may tax experts, have been effectively blocked through enforcement under the present Act. It is impossible however to devise a utopian tax system which will plug all loopholes forever. Therefore, emphasis must be placed on effective administration and interpretation of the Act in order to minimize evasion or avoidance rather than trying to develop a document which will be air-tight in perpetuity.

The history of all tax acts have illustrated that amendments will be required each year for a variety of reasons. It

is almost certain that a completely new income tax act will require far more changes than will revisions made to a previous act.

B. UNCERTAINTIES OF FORECASTING IMPACT

CAODC definitely agrees with the following comments in the White Paper concerning the hazards of forecasting:

> "It is always hazardous to forecast revenues from income taxes. Part of the risk is in economic forecasting, which must cover not only total incomes but their broad distribution. Moreover, corporate profits are more difficult to forecast than other variables - because they depend on changes in production, prices and costs, which can interact in an almost limitless number of ways - yet they are the basis of corporation income tax and affect capital gains substantially. These normal difficulties have been increased in recent years because substantial changes have been made in tax laws, particularly those relating to capital cost allowances." (8.4)

> "The hazards of forecasting are increased when major changes are made in the tax structure. To estimate their effects it is necessary to know, to assume or to forecast on the basis of partial data, a number of factors that have not previously borne directly upon tax yields and are not reflected in tax statistics or other economic statistics. It is also necessary to forecast the reaction of taxpayers when confronted with new opportunities or new limitations on their behaviour. These risks are particularly important in connection with the current program." (8.5)

It is impossible to assess in advance the impact which the major proposals, if implemented, would have on the Canadian economy. In the interest of all Canadians (including taxpayers, investors and those who are partially or completely dependent on

government social programs), we cannot run the risk that the proposals, if implemented, would have an adverse effect on the Canadian economy. The lower income groups will be the first to suffer if there is a decline in economic activity. A decline, which would be difficult to reverse, would hurt the group of taxpayers which the White Paper is trying to protect.

The White Paper suggests (1.12) that the present reform proposals should produce a reasonably stable system which can develop, but which need not be fundamentally revised for a considerable period. However, the White Paper also suggests that other reforms may be introduced at a later date (e.g. changes in sales tax, and capital cost allowance schedules etcetera), and that tax rates may need to be changed in future to meet economic circumstances and requirements for expenditures. These suggestions are very disconcerting since: (i) it is impossible to make a proper assessment of the overall impact of the White Paper tax reform proposals if other proposals are to be introduced at a later date; and, (ii) it seems to contradict paragraph 1.12.

C. OVERALL CAODC RECOMMENDATION

It is unfair and unrealistic for the Government to expect interested parties to be in a position to suggest alternatives to the major White Paper tax reform proposals. There has not

been sufficient time, budget or other resources to develop and assess the impact of alternatives, keeping in mind the sizeable staff and millions of dollars spent by the Government since 1962 in studying tax reform. Also, although the White Paper itself was released in November 1969, the supplementary papers referred to in the Paper were not released until March 1970 and a technical paper dealing with mining and petroleum has not, and may not, be released.

The investment community and taxpayers have been operating under a blanket of uncertainty since 1962 regarding possible change in taxation ground rules affecting business decisions. This uncertainty should be removed as soon as possible.

Because many White Paper proposals are inter-dependent, it will be impossible to remove unworkable proposals without modifying others, which could be time-consuming.

In order to avoid this needless step and to remove the cloud of uncertainty as quickly as possible, the most sensible route to follow would be to retain the present Act, subject to reasonable modifications implemented over time, and which are acceptable to taxpayers, the business community and the appropriate levels of government.

OFFSHORE DRILLING RIG SEDCO H
CONSTRUCTED BY HALIFAX SHIPYARDS, HALIFAX, NOVA SCOTIA
FOR SOUTHEASTERN COMMONWEALTH DRILLING LTD.

loans, university support, retraining and industrial development. Yet the tax reform proposals will have the effect of penalizing those Canadians who have the initiative to take advantage of such programs.

All levels of government have an important responsibility to keep their expenditures (including those associated with proposed new social programs) within financial boundaries that can be supported from existing revenue sources. This will require creation of priorities in allocating revenues to existing and proposed programs.

Mr. G. Arnold Hart, Chairman of the Bank of Montreal, made the following comment regarding future spending programs referred to in the White Paper: 3/

> "The White Paper is based on the unsubstantiated assumption that the Government needs more money for programs that the public has not asked for .. . . This assumption is very disturbing for it suggests that the Government knows best how future gains in the income produced in the private sector should be spent, and moreover, knows this in advance before consulting the electorate as to its wishes --- Incredibly, we have a situation where Canadians are being invited to submit to higher taxes, not to pay for programs they have asked for, not even for programs that have been put to them in an election platform, but just because the Government makes a bland assertion that it will need more money and therefore proposes to write itself a blank cheque on the collective bank account."

3/ In a December 1969 speech to shareholders of the Bank of Montreal.

The Honourable J.V. Clyne, Chairman and Chief Executive Officer of MacMillan Bloedel Limited, also commented on these proposed spending programs: 4/

> ". . . I will confine myself to a discussion of the White Paper not so much as a proposal for tax reform but as a document designed to create revenue for a broad undefined scheme of social change in Canada. I believe, on the evidence we have seen, that the White Paper is only part of that scheme and that the great debate on tax reform can reach no real conclusion until the Government has revealed more of its intentions. What programmes has it in mind that would require the vast sums the White Paper would produce? How can those of us outside government be expected to make a qualitative judgment on tax proposals without knowing what projects are planned and what they will cost? It is unprecedented for a government to seek new revenue on this scale without saying where it proposes to use it."

CAODC believes in personal initiative and incentives but disagrees with introduction of social or other programs which have the effect of increasing the relative importance of the public sector's share of total GNP. The sixth annual report of the Economic Council of Canada indicated that the public sector share would increase from 32 per cent in 1968 to 37 per cent in 1975.

4/ "The White Paper -- A Summing Up" - an address to the Canadian Tax Foundation Conference in Montreal by The Honourable J.V. Clyne, Chairman and Chief Executive Officer, MacMillan Bloedel Limited, March 25, 1970.

Recent trends suggest the 37 per cent level will be reached much sooner. In contrast, the public sector in the U.S. accounts for only 31.4 per cent of its total GNP, 4/ even with the sizeable expenditures associated with the Vietnam War and the Space Program. Without these two major expenditures the ratio of the public sector to total GNP in the U.S. might be as low as 25 per cent. CAODC questions why we have to be so far out of line with the U.S. in this regard.

The White Paper recognized that its proposals would increase the relative importance of the public sector, as indicated by the following comment:

> "These (reductions in capital expenditures of CHCs and the mineral industries) would be offset by a small immediate increase in public revenues, and a rather larger increase after the early transitional years. These aggregate changes, however, could be taken into account in the determination of monetary and fiscal policy and could be offset in their general effects on total incomes, employment and prices." (8.49)

In regard to this shift from the private to public sector, CAODC agrees with Mr. Clyne's comments, as follows: 4/

> "Now in Canada, we are asked to acçept a system of taxation that would gradually drain off the reservoir of individual private savings to the public sector where

decisions as to its investment would largely be in the hands of civil servants. While their management of investments might be very skillful, we would not expect to get much from them in the way of risk capital, which is precisely the kind that has sparked Canada's development. We must ask ourselves if such a system is one which we desire where initiative is taken from private citizens and given to government. Only when we have answered that question are we ready to write new tax legislation."

"Now there is no doubt that massive amounts of money must be allocated to the relief of suffering wherever it is found in a modern society with humane objectives. But to what level can public sector spending go before the ability of the country to carry on as a healthy economic entity begins to disintegrate? One either has a free competitive system or one has not, and at some point continued enlargement of government participation or intervention in the economy of a country will transform it to one of total state control.

No one can say with assurance how close we are to that point, but I suggest that we will reach it soon unless as much attention is paid to the pace and priorities of government spending as has been given to the revenue side of government activities during the past seven-and-a-half years."

Section IX

CAODC RECOMMENDATION TO THE MINISTER OF FINANCE

Both the Minister of Finance and the Prime Minister have stressed that persons or organizations which are critical of specific White Paper proposals should make alternative recommendations. For example, in his recent Toronto speech, the Prime Minister commented: 1/

> "If they object to specific measures, they should suggest practical alternative methods of achieving the objectives to which they agree."

The purpose of this section is to summarize the overall CAODC recommendation to the Minister of Finance concerning the major proposals for tax reform. However, the section first deals with two related subjects - (1) administrative and judicial problems which would be created if these proposals were implemented; and, (2) the uncertainty associated with forecasting impacts of such proposals on the Canadian economy.

A. ADMINISTRATIVE & JUDICIAL PROBLEMS

The goals and standards which guided the authors of the

1/ See footnote 1, Section VIII

White Paper included:

> "widespread understanding of and voluntary compliance with tax laws combined with enough detail to block loopholes." (1.6)

The White Paper is satisfied that the proposed tax reforms are practical and effective measures, as indicated below:

> "The government's proposals are the result of careful study of tax principles, practices and impact. The government believes they are the best practical proposals to attain our objectives in present circumstances." (1.4)
>
> "The following proposals are commended to Canadians as practical and effective measures to accomplish the objectives of tax reform." (1.23)

Prime Minister Trudeau supported this position in his recent Toronto speech[1/] when he said:

> "We believe that this is a good White Paper because it sets out clearly many of the problems of our tax system and suggests methods of solving them."

CAODC believes that there are may aspects of the proposed tax reforms which are impractical and will be extremely difficult to administer, either by corporate taxpayers, individual taxpayers, or by federal and provincial governments.

CAODC is also seriously concerned that these overall proposals, if enacted, would cause a lengthy period of uncertainty during which legal interpretation of the new act was tested in

1/ See footnote 1, Section VIII

the courts. This concern is similar to that expressed in the 1967 CAODC brief to the Minister of Finance regarding the Report of the Royal Commission on Taxation, in which CAODC stated:

> "The proposed tax system will require years of training for Revenue Department and private business staffs. It will be costly and difficult to administer. It will also cause many years of uncertainty as to judicial interpretation. This uncertainty will prejudice further investments in Canada as the application and effect of these tax laws will be unknown. The Association submits that the present system of taxation, with which people in this and other countries are familiar, will with necessary modifications from time to time, continue to serve this country admirably."

The White Paper objective to block loopholes is commendable. In fact, may of the types of loopholes referred to throughout the White Paper, wuch as surplus-stripping and associated companies, in the opinion of may tax experts, have been effectively blocked through enforcement under the present Act. It is impossible however to devise a utopian tax system which will plug all loopholes forever. Therefore, emphasis must be placed on effective administration and interpretation of the Act in order to minimize evasion or avoidance rather than trying to develop a document which will be air-tight in perpetuity.

The history of all tax acts have illustrated that amendments will be required each year for a variety of reasons. It

is almost certain that a completely new income tax act will require far more changes than will revisions made to a previous act.

B. UNCERTAINTIES OF FORECASTING IMPACT

CAODC definitely agrees with the following comments in the White Paper concerning the hazards of forecasting:

> "It is always hazardous to forecast revenues from income taxes. Part of the risk is in economic forecasting, which must cover not only total incomes but their broad distribution. Moreover, corporate profits are more difficult to forecast than other variables - because they depend on changes in production, prices and costs, which can interact in an almost limitless number of ways - yet they are the basis of corporation income tax and affect capital gains substantially. These normal difficulties have been increased in recent years because substantial changes have been made in tax laws, particularly those relating to capital cost allowances." (8.4)

> "The hazards of forecasting are increased when major changes are made in the tax structure. To estimate their effects it is necessary to know, to assume or to forecast on the basis of partial data, a number of factors that have not previously borne directly upon tax yields and are not reflected in tax statistics or other economic statistics. It is also necessary to forecast the reaction of taxpayers when confronted with new opportunities or new limitations on their behaviour. These risks are particularly important in connection with the current program." (8.5)

It is impossible to assess in advance the impact which the major proposals, if implemented, would have on the Canadian economy. In the interest of all Canadians (including taxpayers, investors and those who are partially or completely dependent on

government social programs), we cannot run the risk that the proposals, if implemented, would have an adverse effect on the Canadian economy. The lower income groups will be the first to suffer if there is a decline in economic activity. A decline, which would be difficult to reverse, would hurt the group of taxpayers which the White Paper is trying to protect.

The White Paper suggests (1.12) that the present reform proposals should produce a reasonably stable system which can develop, but which need not be fundamentally revised for a considerable period. However, the White Paper also suggests that other reforms may be introduced at a later date (e.g. changes in sales tax, and capital cost allowance schedules etcetera), and that tax rates may need to be changed in future to meet economic circumstances and requirements for expenditures. These suggestions are very disconcerting since: (i) it is impossible to make a proper assessment of the overall impact of the White Paper tax reform proposals if other proposals are to be introduced at a later date; and, (ii) it seems to contradict paragraph 1.12.

C. OVERALL CAODC RECOMMENDATION

It is unfair and unrealistic for the Government to expect interested parties to be in a position to suggest alternatives to the major White Paper tax reform proposals. There has not

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The investment community and taxpayers have been operating under a blanket of uncertainty since 1962 regarding possible change in taxation ground rules affecting business decisions. This uncertainty should be removed as soon as possible.

Because many White Paper proposals are inter-dependent, it will be impossible to remove unworkable proposals without modifying others, which could be time-consuming.

In order to avoid this needless step and to remove the cloud of uncertainty as quickly as possible, the most sensible route to follow would be to retain the present Act, subject to reasonable modifications implemented over time, and which are acceptable to taxpayers, the business community and the appropriate levels of government.

APPENDIX "F"

B R I E F

THE STANDING SENATE COMMITTEE ON BANKING,

TRADE AND COMMERCE.

BY

THE NATIONAL ASSOCIATION OF TOBACCO
AND CONFECTIONERY DISTRIBUTORS
MONTREAL

SUBJECT

THE "BENSON" WHITE PAPER ON TAXATION

PROPOSED BRIEF

INTRODUCTION

We, representatives of the National Association of Tobacco and Confectionery Distributors, submit on behalf of our members, wholesalers of tobacco and confectionery in Canada, this Brief, which outlines our specific objections to, and suggestions for revision with regard proposals contained the "White Paper" On Taxation.

Wholesalers of tobacco and confectionery are the middlemen between the manufacturers or suppliers of these products and the retailers. As such, their business is characterized by a low margin of profit, very high overhead, considerable capital investment and the extension of credit to their customers. Wholesalers by and large, are considered as small business enterprises (C. H. C.) which would be affected strongly by certain of Mr. Benson's Proposals.

There are however, several firms represented in our membership which are W. H. C. and which firms would be effected in the matter of the 5 year re-evaluation of capital.

The wholesaling function is a most necessary contribution to the standard of living enjoyed by Canadians, the distributive process assures that merchandise of all types is placed at point of sale at minimal cost. This function offers employment for many in our industry and price advantage to consumers.

THE BRIEF

GENERAL COMMENTS: The "White Paper" stresses the closeness of the shareholders of a closely held corporation to the corporation itself and expresses the desire that the corporations tax should be related as closely as possible to rates paid by individual shareholders (1)

During the course of our meeting with the Honourable Edgar J. Benson on February 26, 1970 in Ottawa, Mr. Benson emphasized paragraph 4, 18 (2), namely the problems arising from the build-up of large corporate surpluses and the present resistance to the eventual taxation of these surpluses by the shareholders. It was our understanding

(1) Paragraph 1, 40 -

that Mr. Benson felt that by establishing a uniform rate of corporate income tax and by requiring a dividend payment within $2\frac{1}{2}$ years if the corporations' taxes were to be creditable to the shareholders, that many of the present tax manipulations and injustices would be eliminated.

Bearing in mind the purpose and nature of the White Paper's objectives pertaining to the taxation of closely held corporations, we shall in the paragraphs that follow, offer an alternative which will considerably ease the effects of the proposed increase in rates from 21% to 50% over a period of 5 years for closely held companies on the first $35,000 of net profits.

CONSIDERATIONS AND EFFECTS OF INCREASING THE RATE OF TAX APPLICABLE TO C. H. C. 'S AND TO TOBACCO WHOLESALERS IN PARTICULAR : Tobacco wholesalers generally operate on a comparatively very small mark-up on sales. Consequently, a large volume of sales is required in order to arrive at a reasonable rate of return on invested capital. In order to achieve this sales figure, a large and varied inventory is required.

With few exceptions, the members of the N. A. T. C. D. are comprised of "C. H. C. 's". These depend largely on their profits in order to finance the increasingly larger inventories required by a growing concern.

These independent wholesalers are now faced with eventual increased taxes up to a maximum of $10, 150 annually (50% - 21% or 29% x $35, 000). If they choose and qualify to be taxed under the "partnership option" the increase may be somewhat less pronounced, but it constitutes a material increase, nevertheless.

The inevitable result of the significant drain on working capital caused by the proposed tax increase on corporations will be to:

1) seriously curtail the growth of existing "C. H. C. 's";

2) discourage the initiation of new business ventures;

the tobacco wholesaler, with his large inventory requirements coupled with his low gross profit on sales would have the following logical options:

1) to sell out to larger competitors;

2) to merge;

3) to close down

It would be most difficult for the family owned business to survive in the tradition of free enterprise that has been characteristic of the "Canadian way" of doing business, since the beginning of Canada.

THE ALTERNATIVE: Paragraph 4, 27 proposes that corporations eventually be taxed at a flat 50% rate and that dividends be passed on to the shareholders within $2\frac{1}{2}$ years from the end of the corporation's year end.

Payment of dividends within this period would permit shareholders to receive full credit for corporation taxes already paid, when calculating their personal tax liabilities. This procedure would further eliminate the accumulation of undistributed surplus. However, it would inevitably cause the hardships to small corporations already described.

The proposed alternative would be to leave the $35,000 tax umbrella in tact for companies whose profits are less than 100,000 annually. This $35,000 exemption could be reduced at the rate of $500 for each $1,000 that the company earned over $100,000. This This means that a company which earned $120,000 would benefit from only a $25,000 exemption and one with net profits of 170,000

would have no exemption at all. The second phase would be to require the payment of a dividend within 5 years after the end of the corporations taxation year-end if the tax paid by the company is to be creditable to the shareholders. Companies earning between 35,000 and 100,000 would dirive the maximum benefit of an annual tax deferrment of 10,150 (50 - 21% or 29% x 35,000) whereas those earning up to 35,000 or between 100,000 and 170,000 would derive benefits to lesser degrees. Since dividend distributions of each year's earnings would only made 5 years later, a company could benefit by an interest free tax deferrment equal to 5 times 10,150 or $50,750.

Other "technical" considerations would be the retention of the present tax loss carry-over provisions. Therefore, income subject to distribution would be the lesser of:

a) net income after deduction of another year's tax losses, or

b) the company's undistributed income on hand on the day that the dividend to shareholders is declared.

THE FOREGOING PLAN WOULD:

1) considerably ease the strain on working capital to smaller companies, as defined;

2) provide that corporation profits be taxed at personal rates as proposed by the White Paper, within 5 years,

3) eliminate the build-up of corporate surpluses with the same effectiveness as the "White Paper" presently proposes.

<u>OTHER ALTERNATIVES:</u> Whereas it is generally agreed that small companies will need some assistance to survive at a 50% rate of tax, two other alternatives were also examined.

1. Depreciation of plant and equipment at accelerated rates was one. This would not be of any great assistance to tobacco wholesales whose primary problem is the financing of large inventories.

2. Loans by the Government to C. H. C. 's was another. Even if these were interest free they would:

a) restrict the company's over all borrowing power

b) the loans could not be reduced by subsequent tax-losses

c) in the light of the present administration of the "Small Business Loans Act" and of the operations of the Industrial Development Bank, these loans might become too entangled in "red tape" causing the whole lending process to become ineffective.

Neither the "accelerated depreciation" alternative nor the "Government Tax-Loan" alternative are considered by us to be suitable ones.

CONVENTIONS: Mr. Benson mentioned to us that his intention in proposing the elimination of the deductibility of entertainment and related expenses was to eliminate present abuses.

The proposed legislation would seriously affect NATCD Conventions which have given members the opportunity to discuss and resolve common problems as well as to attend the educational seminars conducted at these Conventions and to conduct association business. These conventions are of direct benefit to members in earning better livlihoods in the field of tobacco wholesaling. We feel it only reasonable to request that attendance at N. A. T. C. D. and similar conventions continue to be deductible for income tax purposes.

For facility of administration, associations such as ours could be asked to register details of the nature of conventions before holding them. If they met with Government guidelines, the Tax Department would issue a registration number in the same manner as it now does to charitable institutions. The receipt would authorize the taxpayer to deduct registrations fees to the Convention as well as travelling and related expenses. This procedure would permit the Government to evaluate conventions individually and prevent abuses.

FIVE-YEAR REVALUATION OF SHARES IN WIDELY HELD CORPORATIONS: This revaluation for purposes of determining a taxpayer's capital - gains tax liability will not be dealt with at any length, in view of Mr. Benson's official statements suggesting that this matter was receiving further consideration.

CONCLUSION: We are hopeful that our proposals may receive your favourable consideration, so that small business may continue as a way of Canadian business life and so that the Canadian Tobacco Wholesalers may continue to make their full contribution to the Canadian economy within the framework of a system of taxation that is fair to all, one that recognizes the inherent problems of small business.

Respectfully submitted,

THE LEGISLATION COMMITTEE OF THE N. A. T. C. D.

Consisting of: E. J. Hartnett, Chairman of the Legislation Committee
Paul Kaiser, B. Comm., C. A. Consultant
John L. Cunningham, Assistant Director N. A. T. C. D.

Queen's Printer for Canada, Ottawa, 1970

Canada. Parl. Senate. Standing
Committee on Banking, Trade and
Commerce
    Proceedings....

Lacking issue no. 38, 28th Parl., 2nd sess.

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 39

TUESDAY, SEPTEMBER 15th, 1970

Thirty-Second Proceedings on the Government White Paper, entitled:

"PROPOSALS FOR TAX REFORM"

APPENDICES:
(Supplementary Information)
(For list of Appendices see Minutes of Proceedings—Page 39 : 5)

22622—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (*Rigaud*)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (*Ottawa West*)	Hays	White
Cook	Hollett	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*) moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Clerk of the Senate.
ROBERT FORTIER,

22622—1½

MINUTES OF PROCEEDINGS

TUESDAY, September 15th, 1970.
(66)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 10:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aird, Beaubien, Benidickson, Blois, Carter, Connolly (*Ottawa West*), Cook, Everett, Gélinas, Haig, Isnor, Molson and Phillips (*Rigaud*)—(14).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive-Secretary.

Upon motion it was *Resolved* to print as Appendices the Supplementary Information received from the following:

1. The Steel Company of Canada, Limited;
2. Canadian Labour Congress;
3. Derry, Michener & Booth;
4. James Richardson & Sons, Limited;
5. Alcan Aluminium Limited;
6. Bethlehem Copper Corporation Ltd.;
7. Caisses Populaires Desjardins;
8. Canadian Art Museum Directors Organization;
9. The Canadian Institute of Chartered Accountants;
10. The Canadian Medical Association;
11. Canadian Pulp and Paper Association;
12. Co-operative Union of Canada and Le Conseil Canadien de la Coopération;
13. Dominion Foundries and Steel, Limited;
14. Imperial Oil Limited;
15. International Utilities Corporation;
16. King Resources Company;
17. McIntyre Porcupine Mines Limited;
18. Liberian Iron Ore Limited (Lio);
19. Massey-Ferguson Limited;
20. Canadian Construction Association;
21. The Toronto Stock Exchange;

22. Texaco Canada Limited;
23. Syncrude Canada Ltd.;
24. Shell Canada Limited;
25. Retail Council of Canada;
26. The Robert Simpson Company Limited and
27. National Sea Products Limited.

At 10:20 a.m. the Committee proceeded *in camera* and at 6:10 p.m. adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

APPENDIX 1

The Steel Company of Canada, Limited
P.O. Box 205, Toronto Dominion Centre
Toronto 111, Ontario

June 8, 1970

The Honourable S. A. Hayden
Chairman
Standing Senate Committee on
Banking, Trade and Commerce
Ottawa, Ontario

Dear Mr. Hayden:

Re: Submission on Proposals for Tax Reform
by Algoma, Dofasco and Stelco

I am enclosing copies of the following correspondence being forwarded today to the Standing Committee on Finance, Trade and Economic Affairs.

(1) Projections prepared by Clarkson, Gordon & Co. illustrating the effect of the present and proposed mining incentives on a typical mining operation of a Canadian steel producer.

(2) Information regarding the impact of the mining incentives on Stelco's earnings during the 1960's.

(3) A suggestion as to a possible alteration of the present rules regarding exempt mining income.

This information was requested by the Commons Committee during our hearing on May 7. I believe that it is self-explanatory and that you may find it a useful addition to the evidence we gave before your Committee on May 6.

Yours very truly,

Norman J. Brown
Vice-President and Comptroller

NJB/MM
Encl.

Copy to: ✓Mr. R. B. Breton, Executive Secretary
Standing Senate Committee on Banking, Trade and Commerce

The Steel Company of Canada, Limited
P.O. Box 205, Toronto Dominion Centre
Toronto 111, Ontario

June 8, 1970

Mr. Gaston Clermont, M.P.
Chairman
Standing Committee on Finance,
Trade and Economic Affairs
Ottawa, Ontario

Dear Mr. Clermont:

Re: Submission on Proposals for Tax Reform by Algoma, Dofasco and Stelco

At the hearing before your Committee on May 7, we were asked to submit the working papers prepared by Clarkson, Gordon & Co., illustrating the effect of the White Paper proposals on the profitability of investment in iron ore mines in Canada.

The material enclosed has been prepared by Clarkson's and is presented in the form of cash flows for a typical iron ore mining investment by a Canadian steel producer. It is based on composite figures for specific mining projects now operated by one or more of the three steel companies and is, therefore, considered to be representative of an actual situation.

The material includes the following:

(1) a memorandum prepared by Clarkson, Gordon & Co. describing the assumptions on which the figures are based and indicating the conclusions

CLARKSON, GORDON & COMPANY

June 5, 1970

THE THREE STEEL COMPANIES

STUDY OF THE EFFECT OF THE WHITE PAPER PROPOSALS
ON A TYPICAL IRON ORE MINING PROJECT

The data used for the purposes of the "typical iron ore mining project" in this study are based on weighted averages of the actual and projected results for the operating mines of the three Steel Companies. The weighted average figures have been rounded slightly to simplify calculations. The resulting data is considered to be representative of the actual and projected results of the operating iron ore mines.

Summary of data and assumptions

1. Annual production has been taken as 1,300,000 tons of iron ore pellets.

Annual rates of production of the operating mines were as follows:

MacLeod (Algoma)	1,375,000 tons
Wabush (Stelco)	1,536,000 "
Wabush (Dofasco)	1,014,000 "
Sherman (Dofasco)	1,012,000 "
Griffith (Stelco)	1,500,000 "

2. Pre-tax profit (before capital cost allowance and preproduction expenses) from the production of prime metal from ore derived from the mine is assumed to be $16.60 per ton of pellet production. It has been assumed that this profit margin will remain constant (i.e. that increased operating costs will be offset by corresponding increases in selling prices).

3. Capital expenditures were assumed to be as follows:

	Total for 1,300,000 tons annual production	Investment per ton
Preproduction and mine development expenses	$ 7,540,000	$ 5.80
Depreciable mine, plant and equipment	48,490,000	37.30
Investment in related facilities (e.g. railways)	3,000,000	2.31
Working capital	4,030,000	3.10
Total	$63,060,000	$48.51

The investment in existing pig iron producing facilities not included above was assumed to be $25 million for purposes of capital cost allowance calculations.

The bulk of the exploration and development expenses (Sec.83A) were assumed to have been incurred in the first three years of the preproduction period, with the balance in the fourth year of this period.

Depreciable property outlays were assumed to have been concentrated in the early part of the preproduction period. No further additions were included over the life of the property (30 years including the 4-year preproduction period) as it was assumed that the cost of replacement of the initial facilities would be reflected in the cost of production.

The investment in related facilities was assumed to have been made over the first 5 years with the greatest expenditures in the first two years. It was assumed also that this investment would be recovered evenly over a 15 year period once the expenditures ceased.

4. It was assumed that the company concerned had income from other mines sufficient to absorb capital cost allowance and preproduction expense deductions available in the preproduction period.
5. A tax rate of 52% was used throughout except that deductions available in the preproduction period were assumed to apply against other mining income taxable at an effective rate of 35% under the present system.

Method of calculation

The operating results for a typical iron ore mining project have been projected over the assumed life of the mine (30 years including a four year preproduction period) under the present tax legislation, the White Paper proposals, and also on the assumption that neither exemption nor depletion under the present tax legislation was available. In order to measure these results on a common basis, the net cash flow (inflow and outflow) generated by the operation in each year has been discounted to determine a rate of return for each case. It has been assumed that the net cash flow in each year occurred at the beginning of each period.

Results of calculations for typical iron ore mining project

1. The rates of return determined for this project are as follows:

Present tax provisions	13.4%
White Paper proposals	7.7%
Present tax provisions without exemption or depletion	5.8%

2. The reduction in the rate of return under the White Paper proposals is 42.5% when expressed as a percentage of the rate of return under the existing legislation.

3. The following schedule illustrates that the relief provided by the White Paper proposals is 25% of the relief provided by the present exemption and depletion provisions:

	Rate of return
Present tax provisions	13.4%
Present tax provisions without exemption or depletion	5.8
Relief provided by exemption and depletion in terms of rate of return	7.6
White Paper proposals	7.7
Present tax provisions without exemption or depletion	5.8
Relief provided by White Paper proposals in terms of rate of return	1.9
Relief provided under White Paper proposals as % of relief provided by present exemption and depletion provisions	25%

The Steel Company of Canada, Limited
P.O. Box 205, Toronto Dominion Centre
Toronto 111, Ontario

June 8, 1970

Mr. Gaston Clermont, M.P.
Chairman
Standing Committee on Finance,
Trade and Economic Affairs
Ottawa, Ontario

Dear Mr. Clermont:

Re: Submission on Proposals for Tax Reform by Algoma, Dofasco and Stelco

During the hearing before your Committee on May 7, the question was raised as to whether the steel companies were prepared to suggest possible alternatives to the present mining incentives.

We believe that the existing tax law is uniquely suited to the needs of the Canadian steel industry. It provides a sufficient tax reduction to make the development of Canadian iron ore properties economically feasible, and at the same time, it provides an incentive to process the iron ore in Canada to finished steel products. As we pointed out at the hearing, there have been no "bonanzas" in iron ore mining, nor are there likely to be.

Nevertheless, as protection against abuse by the "bonanza" type of project, we would suggest that the amount of exempt income permitted could be limited to the lesser of the income earned in a three-year period or the amount of the investment in the project. Depletion allowances as currently provided, however, are essential and should be continued in their present form if the Canadian steel industry is to continue to be encouraged to use Canadian iron ore in its operations.

Yours very truly,

H. M. Griffith
President and
Chief Executive Officer

HMG/MM

The Steel Company of Canada, Limited
P.O. Box 205, Toronto Dominion Centre
Toronto 111, Ontario

June 8, 1970

Mr. Gaston Clermont, M.P.
Chairman
Standing Committee on Finance,
Trade and Economic Affairs
Ottawa, Ontario

Dear Mr. Clermont:

Re: Submission on Proposals for Tax Reform by Algoma, Dofasco and Stelco

At the hearing before your Committee on May 7, each of the three companies undertook to supply further information regarding the value of the mining incentives to its own operations in recent years.

The figures for The Steel Company of Canada, Limited are shown on the attached statement. Because the importance of Canadian iron ore mining operations to our Company increased dramatically during the 1960's, the decade has been divided between the years 1960-1965 and 1966-1969. Until 1966, only the Hilton Mine was operated. Wabush Mines started production in 1966, and the Griffith Mine in 1969. Annual production capacities of these mines and Stelco's share of the output are as follows:

	Capacity	Stelco Share
Hilton	800,000 tons	400,000 tons
Wabush	6,000,000 tons	1,536,000 tons
Griffith	1,500,000 tons	1,500,000 tons

The value of the present incentives to Stelco is apparent from the statement attached, with the average tax rate for the ten years being reduced six percentage points (48.4% v. 42.5%) and for the last four years by eleven percentage points (50.1% v. 38.8%). All of the incentive reduction in the period is due to the three-year exemption allowance, and none to depletion. This is because income which would otherwise have been subject to a depletion allowance was fully offset by capital cost allowance and preproduction expense deductions during the construction period of a subsequent project. For example, following

the expiration of the Hilton exempt period on October 1, 1961, deductions for Wabush, which was then under construction, were sufficient to eliminate the income from Hilton.

We would be glad to furnish any further information you may require.

Yours very truly,

Norman J. Brown
Vice-President and Comptroller

NJB/MM
Attach.

Copy to: Miss Dorothy F. Ballantine
Clerk of the Standing Committee on
Finance, Trade and Economic Affairs

THE STEEL COMPANY OF CANADA, LIMITED

EFFECT OF MINING TAX INCENTIVES ON PROFITS - 1960-1969

(Thousand $)

		Tax Provision			Tax Rate	
Period	Profit Before Tax	Before Incentives	Effect of Incentives	After Incentives	Before Incentives	After Incentives
1960-65	$373,406	$175,442	$ 5,248	$170,194	47.0%	45.6%
1966-69	308,234	154,388	34,662	119,726	50.1%	38.8%
	$681,640	$329,830	$39,910	$289,920	48.4%	42.5%

Note: Exempt periods of mines:

Hilton	October 1, 1958-1961
Wabush	April 1, 1966-1969
Griffith	Not yet approved, but assumed to start in late 1969.

APPENDIX 2

September 15, 1970

Mr. Roland B. Breton,
Executive Secretary,
Senate Committee on Banking,
Trade and Commerce,
The Senate,
OTTAWA, Ontario.

Dear Mr. Breton:

Mr. Bell has asked me to supply you with the following supplementary information related to the CLC's brief on the Government White Paper entitled "Proposals for Tax Reform", to the Senate Committee on Banking, Trade and Commerce.

The attached Table 1, extracted from the D.B.S. publication Employment and Average Weekly Wages and Salaries, Cat. No. 72-002, shows larger firm employment as a percentage of total estimated employment by industry division for the year 1969. Larger firms covered in the D.B.S. survey are firms having 20 or more employees in any month of the year.

The total employment statistics used for this table were estimated by D.B.S. by adding together data from the employment and payrolls survey and data from a sample survey of smaller firms which are published monthly in Estimates of Employees by Province and Industry, Cat. No. 72-008.

Table 2 attached shows average weekly wages and salaries, at annual rates, by industry in Canada for the years 1968 and 1969. It should be noted that these are broad national averages and are gross payments before deductions are made for taxes, unemployment insurance, etc. Included are salaries, straight-time wages, overtime wages, cost of living allowances, etc.

Table 3 shows our calculations of sales taxes plus real property taxes which accounted for about 40 per cent of total tax revenue in 1967. As you will notice the sales taxes include federal and provincial general sales taxes as well as provincial estimates for taxes on motor fuel and fuel oil, amusements and admissions, etc.

Our calculations were based on data published in D.B.S. publications 68-203 - Municipal Government Finance, 68-205 - Provincial Government Finance (Estimates), and 68-211 - Federal Government Finance.

This month D.B.S. has published Consolidated Government Finance 1967, Cat. No. 68-202. Table 4 attached, extracted from that publication, shows their final data on tax revenues for all levels of government for the year 1967.

We trust this information will be of some assistance.

Yours sincerely,

(Miss) Dawn Ventura
Research Associate

DV/jl
Attas.
opeiu-225

Table 1

Larger Firm Employment as a Percentage of Total Estimated Employment, by Industry Division, for Canada and Provinces, 1969 Annual Averages(1)

Industry	Canada	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta.	B.C.
	per cent										
Forestry	78.0	82.5	-	53.8	76.7	85.3	85.0	75.3	-	75.9	70.8
Mining, including milling	94.1	99.1	-	98.7	97.2	96.7	93.9	98.2	95.6	89.2	88.3
Manufacturing	90.8	95.6	87.8	92.4	90.7	90.3	92.3	87.9	83.0	84.0	87.5
Durable goods	91.5	86.7	68.3	93.5	85.3	91.6	93.2	88.0	80.6	82.2	87.8
Non-durable goods	90.1	97.2	91.5	91.5	94.0	89.5	91.3	87.9	84.4	85.4	87.2
Construction	60.6	79.2	52.7	63.5	54.1	60.4	60.6	68.4	53.1	63.8	53.3
Transportation, communication and other utilities	89.7	92.8	74.8	88.6	91.8	90.9	88.8	94.3	87.9	86.9	88.8
Trade	61.0	60.4	43.5	58.6	63.0	55.7	64.0	69.0	56.3	61.8	59.8
Finance, insurance and real estate	80.6	91.3	76.0	83.6	84.5	78.6	83.6	84.7	71.6	81.0	72.2
Service	19.2	14.8	7.9	12.1	10.5	17.1	21.3	22.2	11.7	21.7	21.6
Industrial composite	57.7	55.5	37.4	50.5	54.0	58.5	60.9	59.5	43.2	51.8	55.2

(1) See notes for explanation.

Table 2

Average Annual Wages and Salaries

	Industrial Composite	Forestry	Mining	Mfg.	Constr.	Trans. Comm. & Other Utilities	Trade	Finance Insurance & Real Estate	Service
1968	5,714	6,346	7,236	5,950	7,155	6,380	4,519	5,523	4,107
1969	6,117	6,947	7,744	6,392	7,835	6,814	4,878	5,919	4,380

Source: D.B.S. 72-002 Employment and Average Weekly Wages and Salaries

DV/jl
Sept. 1970
opeiu-225

Table 3

All Levels of Government - Tax Revenue

Fiscal Year Ended Nearest December 31, 1967

$ Millions

	Federal	Provincial-Municipal (1)	Total
Taxes			
Income			
Corporation	1,821	605	2,426
Personal	3,650	1,465	5,115
On Certain Payments & Credits to Non-Residents	221	-	221
On Premiums of Insurance Co's	-	57)	57)
Other, on Corporations	-	)	)
Real, Personal Property & Special Assessments	-	2,469	2,469
Business	-	213	213
Poll	-	4	4
Total Income			10,505
Sales			
General	2,146	1,258	3,404
Motor Fuel & Fuel Oil	-	793	793
Amusements & Admissions	-	51	51
Tobacco	-	78	78
Other Commodities & Services	-	52	52
Total Sales			4,379
Other Taxes*	1,720	401	2,121
Total Taxes			17,005
Total Sales Taxes Plus Real Property Taxes			6,848
Total Sales & Real Property Taxes as a % of Total Taxes			40.3

Source: D.B.S.

(1) Provincial Estimates

*Includes: Excise duties and special excise taxes, customs import duties, estate taxes and succession duties, hospital insurance premiums and other.

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Table 4

All Levels of Government - Tax Revenue

Fiscal Year Ended Nearest December 31, 1967

	Total
Taxes	
Income	
Corporation	2,417
Personal	5,112
On Certain Payments & Credits to Non-Residents	220
On Premiums of Insurance Co's	58
Other, on Corporations	28
Real, Personal Property & Special Assessments	2,466
Business	213
Poll	3
Sub Total	10,517
Sales	
General	3,405
Motor Fuel & Oil	793
Alcoholic Beverages	1
Amusements & Admissions	53
Tobacco	76
Other Commodities & Services	64
Sub Total	4,392
Other Taxes*	2,090
Total Taxes	16,998
Total Sales Taxes Plus Real Property Taxes	6,858
Total Sales & Real Property Taxes as a % of Total Taxes	40.3

Source: D.B.S. 68-202 Consolidated Government Finance 1967

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Sept. 1970
opeiu-225

APPENDIX 3

MULTIPLY ALL FIGURES BY 1000

DERRY, MICHENER & BOOTH, Mining Geological Consultants.

COMPARISON AND EFFECT OF TAXATION RELATIVE TO EXPLORATION & DEVELOPMENT & DEPLETION ALLOWANCE

	CASE A No Exploration & Development			CASE B Spends 25% of Optional Profit on Exploration & Development			CASE C Spends 50% of Profit On Exploration & Development			CASE D Spends 75% of Optional Profit on Exploration & Development		
	Now	White Paper	Study Group Proposal	Now	White Paper	Study Group Proposal	Now	White Paper	Study Group Proposal	Now	White Paper	Study Group Proposal
Operating Profit After Capital Write-Off	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200
Exploration and Development Expenses	NIL	NIL	NIL	300	300	300	600	600	600	900	900	900
Net After Exploration & Development	1200	1200	1200	900	900	900	600	600	600	300	300	300
Depletion Allowance	400	NIL	NIL	300	100	150	200	200	400	100	300	600
Taxable	800	1200	1200	600	800	750	400	400	200	200	NIL	MINUS 300 CARRY FWD
Tax @ 50%	400	600	600	300	400	375	200	200	100	100	NIL	NIL
Distributable Equity	800	600	600	600	500	525	400	400	500	200	300	300

APPENDIX 4

JAMES RICHARDSON & SONS, LIMITED

September 8, 1970.

TO HONOURABLE MEMBERS OF THE SENATE OF CANADA

Since the publication on November 7, 1969, of the Government of Canada White Paper, Proposals for Tax Reform, James Richardson & Sons, Limited has made formal submissions to the appropriate Senate of Canada and House of Commons Committees studying the White Paper. A copy of our Brief was sent to you several months ago. We have appreciated the opportunity which the procedure adopted by the Government of Canada afforded, and we hope that the broad approach taken in our Brief has been of assistance.

In our discussion of the White Paper with the members of the Standing Senate Committee on Banking, Trade and Commerce we were impressed with the knowledge of the Committee and with the depth of questioning by the members of that Committee whose report, we believe, will be extremely valuable to the Government.

Much of the debate that has developed around the Proposals has centered upon specific problems rather than on the basic concepts in the "core proposals". Our concern is that in the modification of these specific aspects, the "core proposals", being the structural concepts of the White Paper, may receive an unjustified acceptance. We have prepared a separate evaluation of these areas which we enclose. We are sending copies to the Prime Minister of Canada, Federal Minister of Finance, members of the House of Commons and to the Provincial Premiers and Ministers of Finance.

The enclosed evaluation is intended to advance the view that a fair and viable distribution of the tax burden may be achieved without the imposition of the controversial core proposals. It is our belief that their adoption would cause irreparable damage to the economy.

George T. Richardson,
President.

Encl.

AN EVALUATION OF THE CORE PROPOSALS

OF THE

GOVERNMENT OF CANADA WHITE PAPER

"PROPOSALS FOR TAX REFORM"

BY

JAMES RICHARDSON & SONS, LIMITED

AN EVALUATION OF THE CORE PROPOSALS

The debate upon the White Paper, Proposals for Tax Reform, is now reaching its closing and critical stage. The following has been prepared with respect to a group of inter-related concepts in the White Paper on Tax Reform which we have termed the "core proposals". These are:

* Gross-up and creditable tax
* 50% corporate tax rate
* Maximum 50% personal tax rate
* Closely-held and widely-held companies
* Inter-related capital gains proposals

We believe these proposals are conceptually wrong, and if implemented would have serious implications.

Gross-up and Creditable Tax

The gross-up and creditable tax proposals are intended to result in all income and capital gains being taxed to the individual at his personal rate of tax with some variation in respect to income and capital gains from widely-held companies.

This concept is not justified for the following reasons:

1. It at once destroys different effective rates of corporate tax now in effect for valid reasons when dividends are paid to individuals (e.g. mining, oil, public utilities, real estate, industries in designated areas, international).

2. Income earned by widely-held companies cannot be directly related to the individual shareholders. In fact, a substantial portion will never be paid in cash to the shareholders since earnings are the most important source of new capital and a substantial portion must be retained.

The White Paper attempts to rectify this problem by forced distribution within 2 1/2 years either by cash or stock dividends. Cash dividends in all cases are not feasible and in fact are not desirable, and stock dividends create problems for the shareholder where there is no cash. Obviously a false premise has resulted in an illogical solution.

3. The relationship of the individual shareholder to widely-held companies in which he does not exercise control is remote. Since this is the case, it immediately raises the question why his rate of tax should be related to the effective rate of corporate tax in respect to dividends received from that company.

4. It destroys the incentive for Canadians to invest in companies where there is little or no creditable tax. It is difficult to understand such a proposal since it is one of the objectives of the White Paper

to provide incentives for Canadians to invest in Canadian equities, and it is companies with limited tax which are often the most dynamic.

5. This concept inhibits tax relief for small business.

There is some validity in relating the earnings of closely-held companies with their shareholders to minimize further tax on distribution, but this can be accomplished without adopting the gross-up and creditable tax proposals. To inter-relate gross-up and creditable tax philosophies with closely and widely-held company concepts becomes unworkable and results in gross injustices. The proposals also attempt an identification between the assets of the closely-held company and its shareholders and this also leads to consequences which are unworkable and unjust.

50% Corporate Tax Rate

The core proposals assume that the 50% corporate tax rate will be maintained forever. This is simply not practical. Provincial governments presently level rates of tax which bring the total tax level in some provinces to 53%. One major provincial concern is disparity in corporate tax rates between different jurisdictions, and competition between provinces by varying rates of tax. The 50% rate would only be maintained in Canada if foreign rates of corporate tax are comparable.

Effective corporation income tax rates in the United Kingdom, Japan and Germany are all below (and in some cases, substantially below) the 50% level.

The United States presently has, for several years, had a serious balance of payments problem. If the United States decides to shift corporation tax to specific consumption taxes in order to assist its international competitive position a 50% rate cannot be maintained in Canada.

In any event, corporation tax rates abroad are subject to revision upwards or downwards periodically.

Maximum 50% Personal Tax Rate

The core proposals assume this rate to remain constant forever. Mr. Bryce, the then Deputy Minister, noted in his testimony to the Senate Standing Committee that "it is much more incumbent on Parliament to reach a judgment as to what is an economically tolerable top rate".

If, as is indicated in the White Paper and the representations made in its support, that the 50% is a maximum, one can wonder, with Senator Phillips, why it was thought necessary to start at the top?

The fact is that the proposed maximum rate as adjusted for provincial rates is completely inconsistent with existing provincial rates and revenue requirements. The White Paper proposed to substitute an assumed provincial rate of 22% (of a

larger base) for the present provincial abatement of 28%. The provincial rates in certain provinces exceed the abatement by as much as 35% to 40% so that the economic limits which the White Paper proponents suggest are violated at the outset.

At the same time, the Federal Government advises the provincial governments that they must be prepared to levy their own taxes to support their revenue requirements.

Thus, the government at once insists that the provinces use their own taxing powers to meet their needs, and propose a system of income taxation which according to its own advisors, will be fully stretched at rates which would effectively be lower than existing provincial rates.

Such a scheme can hardly be prudent.

Closely-held and Widely-held Companies

The White Paper attempts to justify the distinctions between widely-held and closely-held companies on the basis of competition, that closely-held companies compete with proprietorships and partnerships and widely-held companies compete with each other and with internationally-owned enterprise.

This justification has been admitted to be inadequate.

While the closely-held concept would ultimately involve a substantial tax saving for shareholders of large closely-held companies (based upon the unlikely assumption that the overall package would work), the means of achieving this condition involve a number of arbitrary consequences upon the disposition of interests in closely-held companies and on the flow of

corporate income through closely-held and widely-held companies. The problems which would be created by the proposed treatment of closely-held companies cannot be readily appreciated from the White Paper, but the complexities of these problems should throw serious doubt on the validity of the concepts which give rise to them.

Inter-related Capital Gains Proposals

Really the argument is whether capital gains should be treated as income for income tax purposes or not. Carter said yes, White Paper says yes, but not quite.

There is, in fact, a difference between capital and income. This is accepted in law and in accounting practice. There are also valid reasons to have a different rate of tax.

Some aspects which distinguish capital transactions are their relative infrequency, size in relation to income flows, the optional nature of realizations, the fact that they arise from and, therefore, derive from a transfer of savings. In dealing with the question of a suitable method (if any) of taxing capital gains, these characteristics need to be taken into account, in order to recognize the broad social requirement to conserve capital and capital formation, in order to achieve relative equity between persons who enjoy capital gains through enhanced value or income flows on the one hand and by realization through sale on the other, and in order to avoid serious distortions of economic decisions.

Despite the opinions of the authors of the White Paper, it is extremely difficult to receive or enjoy income flows without actually receiving them for tax purposes. The situation is far different with respect to appreciation of capital assets.

Furthermore, the quality and certainty of personal income, particularly that received for services, is very different from gains or losses on capital assets.

The possibilities of losses in providing offsets against personal income seem to have escaped the draftsmen of the White Paper, particularly the fact that the recognition of losses or gains is a matter within the discretion of the taxpayer. Perhaps the outrageous proposal to tax unrealized gains on widely-held shares every five years was some recognition of this aspect.

It did not recognize the problem with respect to other assets, however, where indefinite deferral of capital gains tax (at full income rates) can be accomplished, provided that the asset is not sold. In the meantime, the ultimate liability gets more and more indigestible, involving burdens (particularly when combined with estate tax) which are simply unacceptable. The consequences of the proposals in this area are arbitrary in the extreme.

Conclusions

We have concluded that taxation of net capital gains is a desirable complement to the rest of the income tax structure, but that for economic reasons, equity reasons, and the need to

protect the revenue, it should be a uniform rate of tax not significantly higher than 15%, that it should accrue upon realization or death and that it should be deducted (as a liability) from the value of an estate. Capital gains and losses should certainly not simply be aggregated with other income for tax purposes.

The rate of tax on capital gains should bear some relation to tax on undistributed income of corporations, presently about 15% or 16 2/3%, and additionally to the effective tax rate upon dividend distribution. Such an approach would permit all companies to be treated the same and avoid the complex and discriminatory system of gross-up and creditable tax, and closely-held and widely-held companies.

This kind of approach would require that maximum personal tax rates exceed the corporate rate by at least 7 1/2%, in order to avoid complicated tax avoidance schemes based upon the form or organization of the enterprise. Since we cannot foresee that a maximum 50% personal rate is practical, either immediately or in the future, this feature is a good deal more realistic than the White Paper proposal.

There is, of course, no equivalence between undistributed income of a corporation and capital gains on the shares of the corporation, still less with capital gains on assets. The items can, however, be brought together for practical purposes

if assets are held through a corporate medium, and the corporation has both undistributed income and unrealized gains on assets. We suggest that the foregoing is a realistic method of recognizing the special aspects of capital transactions and taxation of undistributed income.

We believe that the foregoing would make significant progress towards tax reform, provide continuity with our existing tax structure and avoid the complexities and rigidities of the core proposals.

September 2, 1970

APPENDIX 5

ALCAN ALUMINIUM LIMITED

Supplemental Brief on Tax Reform

Suggestion for incorporating Flow-through of foreign withholding tax in the existing 20% dividend tax-credit system.

A. The Flow-through - a necessity for multi-national corporations in Canada

Multi-national companies need an environment for home base which minimizes the risk of double-taxation of income flows and imposes minimum tax restraints on foreign corporate reorganizations. Canada has historically had good tax law in this regard, except for a poor posture on withholding taxes. There is hope that the capital gains and foreign dividend exemption-by-treaty proposals can be modified to minimize the damage to multi-national corporate needs. The last point, the withholding tax position, is greatly improved for multi-national companies by the novel and persuasive proposals for a foreign withholding tax flow-through.

Since repeal of Section 2, Article XI of the U.S.A./Canada tax convention in 1961, Canada's international tax policy has been to secure a mutual arrangement whereby each country imposes a 15% tax on dividends in addition to local corporation taxes. Reduced withholding rates are not extended to dividends paid by a direct investment (i.e. by a subsidiary to a foreign parent owning 10% or more of the stock). Most developed countries, however, negotiate special preferential rates of withholding tax on dividends for the parent-subsidiary relationship.

Canada may not wish to change this treaty posture on dividends in view of the degree of foreign ownership in the economy at present, and by imposing a further 15% Canadian W/H on redistribution of these amounts a material level of triple tax on foreign income results (i.e. the local corporation tax, the local withholding tax and a further Canadian withholding tax in the case of non-resident shareholders, Canadian income tax in the case of resident shareholders).

This is a long term factor working against the success of multi-national corporations based in Canada since their foreign source earnings will bear a materially heavier tax charge than similar earnings of their foreign competitors.

The White Paper proposed a method around this problem in the flow-through of non-resident tax. Basically, the flow-through treats the foreign withholding tax as the prior and appropriate tax on ultimate shareholder interest, and waives additional Canadian tax on this income as it flows through a Canadian parent company unless the foreign withholding is less than 15%.

The proposition is sound in that it recognizes the prior right of the source country to tax and treats the Canadian parent as an intermediary for this purpose.

Essentially, the Canadian Treasury would be foregoing only Canadian non-resident tax on foreign source income passing through Canada where the foreign country of source has pre-empted the field by imposing a W/H tax first. This must be considered a first-rate policy for resolving some of the problems in taxing international income.

The criticism levelled at the White Paper proposal for integration of shareholder and corporation tax on other grounds creates concern for salvaging the flow-through concept because it is worth saving. Therefore, we wish to suggest arrangements whereby flow-through can be adapted to the existing tax credit system.

B. Distributions to Non-Residents

The operation of a flow-through of foreign withholding taxes in respect of distributions to non-residents would appear to be the same under both integrated and non-integrated corporation tax systems. That is, the system set out in the White Paper should be workable vis a vis non-residents under the present Income Tax Act.

Essentially, Canada would impose a 15% withholding tax (10% in certain cases) on dividends paid to non-residents. This tax would be imposed and collected by the payor as agent in the normal course of things as at present. However, a separate provision in the Act would permit the paying company to retain such amount of Canadian non-resident tax as is allowed by regulation in respect of foreign withholding taxes paid on account of foreign dividends and branch profits deemed distributed in the dividend.

The key thing in this area is to devise a flow-through that permits the foreign shareholder to obtain a credit against his tax. This can and should be assured by tax treaty, but in the absence of a treaty provision ultimate credit is best assured by imposing a Canadian tax on the foreign income content and then separately forgiving the tax in favor of the Canadian corporation to make its earnings free of the double-tax effect. By this means the foreign country is asked to give credit for a Canadian W/H - not that of a third country.

C. Distributions to Residents

Under integration, flow-through works naturally in the case of resident shareholders because the only tax credit allowed on foreign source income would be the withholding tax credit. In effect, the Canadian parent is functioning much as an intermediary in regard to the flow of foreign income.

In the present system, tax credits are allowed at a fixed rate regardless of the source of income and the amounts of tax paid on the earnings. Flow-through would operate under this type of system by permitting the payor company to deduct a withholding tax from dividends paid to residents at a rate allowed by regulation (the same rate as would be prescribed under B above for recoupment of non-resident tax). Shareholders would include the gross dividend in taxable income and would claim as a tax-credit the uniform amount premitted (say 20% or 25% of net dividends). The tax credit would then in fact be an amalgam of foreign tax flow through and deemed Canadian corporation tax paid.

You will note that under our suggestion the Canadian resident shareholder has a reduced yield equal to the flow-through because the withholding is made, but nothing else changes in the equation. With respect to the reduced yield, Point (7) at paragraph 4.15 of the White Paper criticizes the existing tax credit in that such credit covers foreign and other incomes which have not borne Canadian tax. But more importantly, since the paying corporation retains the withholding tax, it could increase the dividend by that amount if it so

wished. The vital consideration is that foreign withholding tax would not be a charge on company earnings, but would be an anticipatory charge on shareholders. This will facilitate improved earnings prospects for Canadian multi-national companies and offset the impact of Canadian tax-treaty policy in this area.

ALCAN ALUMINIUM LIMITED

COMPARISONS OF ACTUAL INCOME TAXES PAID BY PARTICULAR ALCAN EMPLOYEES IN MONTREAL AND CLEVELAND FOR 1969 *

CANADIAN RESIDENT EMPLOYEES				U.S.A. RESIDENT EMPLOYEES		
Salary			$10,425	Salary		$10,500
Income tax on salary	Canada	$1,323		Income tax on salary		2,043
	Quebec	872	2,195			
Personal exemptions		2,300		Personal exemptions	$600	
Cost of home		-		Mortgage outstanding	-	
				City taxes deducted in 1969	100	
Salary			$12,300	Salary		$11,400
Income tax on salary	Canada	1,008		Income tax on salary		1,200
	Quebec	780	1,788			
Personal exemptions		3,700		Personal exemptions (5)	3,000	
Cost of home		18,000				
Mortgage outstanding		15,000		Mortgage outstanding	15,000	
Interest paid on mortgage in 1969		1,008		Mortgage interest deducted in 1969	1,000	
Municipal & school taxes		470		City & home taxes deducted in 1969	360	
Salary			$14,205	Salary		$14,500
Income tax on salary	Canada	1,842		Income tax on salary		1,099
	Quebec	1,537	3,379			
Personal exemptions		2,300		Personal exemptions (11)	6,600	
Cost of home		34,000				
Mortgage outstanding		25,000		Mortgage outstanding	6,905	
Interest paid on mortgage in 1969		2,375		Mortgage interest deducted in 1969	428	
Municipal & school taxes		806		City & home taxes deducted in 1969	561	
Salary			$15,000	Salary		$14,520
Income tax on salary	Canada	1,723		Income tax on salary		2,093
	Quebec	1,443	3,166			
Personal exemptions		2,850		Personal exemptions (4)	2,400	
Cost of home		20,000		Cost of home	-	
Mortgage outstanding		12,600				
Interest paid on mortgage in 1969		820				
Municipal & school taxes		520				
Salary			$16,200	Salary		$16,500
Income tax on salary	Canada	2,326		Income tax paid on salary		2,137
	Quebec	2,117	4,443			
Personal exemptions		3,150		Personal exemptions (4)	2,400	
Cost of home		35,800				
Mortgage outstanding		21,068		Mortgage outstanding	17,000	
Interest paid on mortgage in 1969		1,571		Mortgage interest deducted in 1969	1,142	
Municipal & school taxes		889		City & home taxed deducted in 1969	468	

Comparison of Actual Income Taxes Paid by Particular Alcan Employees
in Montreal and Cleveland for 1969

Salary			$18,985	Salary		$19,000
Income tax on salary	Canada	$2,724		Income tax paid on salary		3,197
	Quebec	2,384	5,108			
Personal exemptions		2,000		Personal exemptions (5)	$3,000	
Cost of home		27,000				
Mortgage outstanding		3,290		Mortgage outstanding	20,900	
Interest paid on mortgage in 1969		263		Mortgage interest deducted in 1969	1,375	
Municipal & school taxes		947		City & home taxes deducted in 1969	978	

Salary			$20,465	Salary		$20,500
Income tax on salary	Canada	$2,832		Income tax paid on salary		3,139
	Quebec	2,636	5,468			
Personal exemptions		2,600		Personal exemptions (4)	$2,400	
Cost of home		31,500				
Mortgage outstanding		24,500		Mortgage outstanding	37,000	
Interest paid on mortgage in 1969		-		Mortgage interest deducted in 1969	1,902	
Municipal & school taxes in 1969		-		City & home taxes deducted in 1969	1,176	

Salary			$21,250	Salary		$23,500
Income tax on salary	Canada	$2,948		Income tax paid on salary		3,744
	Quebec	2,956	5,904			
Personal exemptions		3,200		Personal exemptions (3)	1,800	
Cost of home		34,500				
Mortgage outstanding		24,012		Mortgage outstanding	9,000	
Interest paid on mortgage in 1969		1,721		Mortgage interest deducted in 1969	486	
Municipal & school taxes		913		City & home taxes deducted in 1969	857	

Salary			$34,500	Salary		$27,000
Income tax on salary	Canada	$6,094		Income tax paid on salary		5,940
	Quebec	5,744	11,838			
Personal exemptions		2,550		Personal exemptions (2)	$1,200	
Cost of home		65,500				
Mortgage outstanding		14,000		Mortgage outstanding	36,000	
Interest paid on mortgage in 1969		1,246		Mortgage interest deducted in 1969	2,531	
Municipal & school taxes		1,864		City & home taxes deducted in 1969 (6 months)	747	

* U.S.A. tax is Federal Income Tax only and excludes social security tax and state and local income, sales taxes.
Canadian tax is Federal and Quebec Income tax. Quebec Pension Plan, sales tax, and family allowance payments are not reflected.

APPENDIX 6

BETHLEHEM COPPER CORPORATION LTD

May 11th, 1970.

Senator The Hon. L.O. Phillips,
The Senate,
Government of Canada,
Parliament Buildings,
Ottawa, Ontario.

Dear Senator:

Following our conversation in Ottawa on April 29th, I telephoned Mr. John Bonus, Managing Director of The Mining Association of Canada in Toronto and told him of the Senate Committee's needs for acceptable alternatives to the proposals contained in the White Paper as they relate to taxation of a mining company. We followed up the telephone call by a letter after our return to Vancouver. Messrs. Steeves, Thiessen, Bruk and I also exchanged ideas and we believe that an acceptable solution is outlined hereunder:

Three-Year Tax-Free Period

The three-year tax-free period provided for by the Income Tax Act is the incentive primarily responsible for the outstanding growth of Canada's mining industry. Nations with whom we compete for mining capital recognize that the risks involved in mineral exploration are so substantial that money for exploration will not be forthcoming unless lucrative incentives are given. The economic and political stability of Canada, added to the tax incentive package, has attracted investment capital even though incentives offered by some other countries are more attractive. Because the tax-free period rewards only successful operations, it is less costly than incentive plans such as direct Government subsidies. The three-year tax-free period provides for recovery of risk money before taxes are payable and the depletion allowance guarantees that the rate of tax paid at the expiration of the tax-free period is reasonable.

The quick write-off of mine assets as proposed by the White Paper is merely a postponement of tax and not a substitution for the incentive provided by the tax-free period.

It is our opinion that the three-year tax-free period should be retained and that an announcement to that effect should be made by the Government at an early date to reassure investors who, because of the uncertainties created by the White Paper, are now reluctant to invest in mineral exploration.

Depletion Allowances

Of prime importance in the consideration of depletion allowances is acknowledgment of the basic premise that the taxation burden on Canadian mining companies should not exceed 50%, the rate paid by other Canadian industries. Because of Provincial mining taxes, the White Paper proposals, if implemented, will produce an effective tax burden on Canadian mining companies in excess of 50%. One method of ensuring that the total does not exceed 50% would be to allow Provincial mining taxes as an offset against Income Tax. Another solution would be to continue percentage depletion at a lesser fixed amount, say 20%, and allow mining taxes and royalties to be fully deductible expenses when calculating Federal taxable income.

Exploration

If, as is the stated intention of the White Paper, an incentive is to be offered for mining exploration, some form of additional depletion must be allowed so as to reduce the tax burden below 50%. The concept of "earned" depletion proposed in the White Paper would accomplish this end. However, the basis on which depletion is earned should be broadened to include all exploration and development and the costs of all assets acquired to exploit a new mine, including items such as townsites, roads, railways and others.

Conclusion

It is important that our tax system recognize the unique risk nature of the industry and that it assures its continuing growth. The plan we recommend would accomplish the desirable objectives:

(1) incentive through the continuation of the three-year tax-free period;

(2) through the depletion allowance ensure that the total tax liability of a mining company never exceeds that of other Canadian business;

(3) through the earned depletion concept encourage continued exploration.

We hope that we have complied with your wishes in our endeavor to make a constructive proposal.

Enclosed is a copy of the material which has been forwarded to Mr. R. Breton, showing how we arrived at the conclusion that our Company is taxed higher in Canada than we would be if our mine were located in Australia, Colorado or Nevada, even at the present time and more so under the White Paper proposals.

Yours very truly,

BETHLEHEM COPPER CORPORATION LTD.

PMR/jm
Encls.

BETHLEHEM COPPER CORPORATION LTD.

SUMMARY OF TAXES BY JURISDICTION ON 20 YEAR PROJECTION ($000)

		Total First Ten Years			Income & Mining		Relation to Present Income Tax Act		Relation to White Paper Total	
		Income Tax		Mining Tax or State Tax	Tax 10th Year x 10	Total	Greater (Lesser) Amount	Percent	Greater (Lesser) Amount	Percent
Canada - White Paper	(1)	$22,590	(1A)	$7,100	$58,200	$87,890	$23,000	35.4	-	-
Canada - Present System	(2)	14,230	(2A)	7,160	43,500	64,890	-	-	$(23,000)	(35.4)
Australia	(3)	18,120		-	37,830	55,950	(8,940)	(13.8)	(31,940)	(36.3)
Colorado	(4)	17,204		1,884	33,990	53,078	(11,812)	(18.2)	(34,812)	(39.6)
Nevada	(5)	18,097		-	32,250	50,347	(14,543)	(22.4)	(37,543)	(42.7)

APPENDIX 7

CAISSES POPULAIRE

STATISTICAL ANNEX

ILLUSTRATING THE INCIDENCE OF INCOME TAX

ON THE OPERATING SURPLUS OF THE CAISSES POPULAIRES

1. Statement of assets and liabilities of the Caisses populaires as of December 31st, 1968.

2. Revenue, expenditures and operating surplus of the Caisses populaires, fiscal year 1969.

3. Estimate of taxation on operating surplus of the Caisses populaires

    I As per the actual taxation system

    II As per the White Paper proposals for tax reform *

    A- Considered as cooperatives

    - Without integration
    - With integration

    B- Considered as ordinary closely-held corporations

    III As per the proposals in our brief*

4. Importance of reserves for the Caisses populaires

5. Importance of reserves in chartered banks

* In these estimates we did not account for the incidence of deductions for doubtful debt reserves and market liquidite reserves allowed for by the White Paper.

Fédération de Québec des Unions régionales des Caisses populaires Desjardins
June 12, 1970

STATEMENT OF ASSETS AND LIABILITIES OF THE CAISSES POPULAIRES
AFFILIATED WITH LA FEDERATION DE QUEBEC DES UNIONS REGIONALES
DES CAISSES POPULAIRES DESJARDINS

As of December 31st, 1968

ASSETS:		Millions of dollars
Cash and demand deposits		$ 296
Investments		381
Loans: Cash loans	342	
Mortgage loans	599	941
Land and buildings	59	
Equipment and furniture	14	73
Other assets		2
Total assets:		$ 1,693

LIABILITIES:	
Share capital	$ 193
Members' deposits	1,399
Loans payable	4
Accounts payable	1
Undivided earnings	20
Reserves	76
TOTAL:	$ 1,693.

STATEMENT OF REVENUE AND EXPENDITURES OF THE CAISSES POPULAIRES AFFILIATED WITH LA FEDERATION DE QUEBEC DES UNIONS REGIONALES DES CAISSES POPULAIRES DESJARDINS

Fiscal year 1969

	Millions of dollars
REVENUE:	
Interest on loans	$ 72.0
Income from investments	23.2
Income from investments in centrals	9.5
Service charges and miscellaneous	6.9
Total revenue:	$ 111.6
EXPENSES:	
Interest on deposits	$ 41.6
Interest on loans payable	0.3
Actual losses on loans	0.3
Depreciation (real estate, furniture and equipment)	3.1
Administration expenses	45.1
Total expenses	$ 90.4
Operating surplus	$ 21.2
DISTRIBUTION OF OPERATING SURPLUS	
Paid to reserves	$ 9.7
Dividends on capital stock	10.5
Added interest on savings	0.5
Patronage refund on loans	0.5
Total operating surplus	$ 21.2

ESTIMATE OF TAXATION ON OPERATING SURPLUS OF THE CAISSES POPULAIRES AFFILIATED WITH LA FEDERATION DE QUEBEC DES UNIONS REGIONALES DES CAISSES POPULAIRES DESJARDINS

Fiscal year 1969

I As per the actual taxation system

- Income tax paid by the Caisses populaires — Nil

By virtue of section 62, paragraph k, chapter 158, revised statutes of Canada 1952, the Caisses populaires are practically income tax exempted

- Income tax paid by members

Federal income tax $ 11.0 millions @ 7.14% (note 1)	$ 0.8 M	
Provincial income tax $ 11.0 millions @ 6.5%	$ 0.7 M	
		$ 1.5 M
TOTAL INCOME TAX		$ 1.5 M

II As per the White Paper proposals for tax reform

A- The Caisses populaires are considered as cooperatives.

1. Not benefiting of integration

Income tax paid by the Caisses populaires		
Operating surplus	$ 21.2 M	
Less dividends (note 2)	$ 10.5 M	
Taxable amount	$ 10.7 M @ 50%	$ 5.4 M
Income tax paid by members 10.5 M @ 13.64%		$ 1.4 M
TOTAL INCOME TAX		$ 6.8 M

II. <u>As per the White Paper proposals for tax reform (cont'd)</u>

2- Benefiting of integration

- Income tax paid by the Caisses populaires			
Operating surplus	$ 21.2 M		
Less dividends (note 2)	10.5 M		
Taxable amount	$ 10.7 M @ 50%		$ 5.4 M
- Income tax paid by members			
Paid dividends	$ 10.5 M		
Plus taxable credit	5.4 M		
Taxable income	$ 15.9 M @ 13.64%	$ 2.2 M	
Less taxable credit		- 5.4 M	- 3.2 M
Total income tax			$ 2.2 M

B. The Caisses populaires are considered as ordinary closely-held corporations.

- Income tax paid by the Caisses populaires			
Operating surplus $ 21.2 M @ 50%			$10.6 M
- Income tax paid by members			
Dividends to be paid	$ 10.6 M		
Plus taxable credit	$ 10.6 M		
Taxable income	$ 21.2 M @ 13.64%	$ 2.9 M	
Less taxable credit		10.6 M	- 7.7 M
Total income tax (note 3)			$ 2.9 M

III. As per the proposals jointly presented by the Co-operative Union - C.C.C. and by the three credit and savings federations of Québec in their briefs.

- Income tax paid by the Caisses populaires		
Operating surplus	$ 21.2 M	
Less capital stock dividends	- 10.5 M	
Less added interest on savings	- 0.5 M	
Less patronage refunds on loans	- 0.5 M	
Taxable amount	$ 9.7 M @ 13.64%	$ 1.3 M
- Income tax paid by members		
Capital stock dividends	$ 10.5 M	
Added interest on savings	$ 0.5 M	
Total income tax (note 4)	$ 11.0 M @ 13.64%	$ 1.5 M
		$ 2.8 M

Note 1. The 1969 edition of "Fiscal Statistics" indicates (p.15) that on a total income of 9225 millions of dollars the citizens of Quebec paid $ 658.8 millions federal income tax and old age security taxes, namely a rate of 7.14%. We estimate at 6.5% of their total income the additionnal income tax paid to the Province of Quebec. In this study we shall use these two rates (7.14% + 6.5% = 13.64%) notwithstanding the fact that they refer to the fiscal year 1967. They are the last figures available.

Note 2. The White Paper proposes that the Caisses populaires yield a rate of return of 8½% (Farm improvement Act) on the capital employed.

This proposition is unacceptable for it would force the Caisses populaires to yield a return on their capital, by far superior to the rate of the market for a similar form of savings, that is redeemable on demand.

The return on the capital must be determined by the financial market and by the paying possibilities of the organization. In this respect, we consider quite equitable the dividends paid by the Caisses populaires in 1969.

Note 3. Even though this hypothesis is very useful to compare us to the private enterprise, the Caisses populaires would refuse to work hypothetically so, for:

1. They would have to fill 2,400,000 T-5 and TP-5 forms having an average value of $ 8.80 of which $ 4.40 in dividends and $ 4.40 in income tax paid.

2. They could not pay anything to their reserves, the amount paid in dividends being redeemable on demand.

   In this hypothesis the Caisses populaires would gain to operate at cost price and to avoid any operating surplus in order not to bear the processing cost fo 2,400,000 T-5 and TP-5 forms. This would be a dangerous administration practice, liable to bring upon losses and even bankruptcy.

   Furthermore, if the Caisses populaires cannot continue to develop their reserves in proportion with their assets, they are doomed to disappear sooner or later.

Note 4. This hypothesis brings 2.8 millions income tax instead of the 2.9 millions brought in hypothesis 11 B because we submit that the patronage refunds on loans should not be taxable in the hands of the members when the interest paid by them was not income tax deductible.

IMPORTANCE OF RESERVES FOR THE CAISSES POPULAIRES

In our brief (pages 7 and 8), we have underlined the necessity for the Caisses populaires to set up important reserve funds. The amount paid to the reserves in these different hypothesis would result as follows:

	Amound paid to the reserves
I Actual situation	$ 9.7 M
II As per the White Paper	
A. Treated as co-operatives	
1. Without integration	$ 5.3 M
2. With integration	$ 5.3 M
B. Treated as ordinary closely-held corporation	0
III As per the proposals in our Briefs	$ 8.4 M

IMPORTANCE OF THE RESERVES OF THE CAISSES POPULAIRES AFFILIATED WITH THE FEDERATION DE QUEBEC DES UNIONS REGIONALES DES CAISSES POPULAIRES DESJARDINS IN PERCENTAGE OF THE ASSETS

As of December 31st.	Assets Millions of dollars	Reserves Millions of dollars	Reserves in % of the assets
1960	$ 688	$ 31	4.49%
1965	1,207	55	4.59%
1966	1,363	62	4.56%
1967	1,548	68	4.38%
1968	1,693	76	4.47%
1969	1,855	85	4.60%

IMPORTANCE OF RESERVES IN CHARTERED BANKS

AS OF DECEMBER 31st, 1969

Through the information taken from the Bank of Canada Statistical Summary and the Canada Gazette we may establish the following figures concerning the Canadian Chartered Banks

Reserves (rest account)	$ 1,189 Millions
Accumulated Appropriations for losses	595
TOTAL RESERVES	$ 1,784 Millions
Total Canadian and Net Foreign Assets	$30,948 Millions
Total Reserves in % of the assets	5.76%

We know furthermore that the chartered banks:

1. Have specific provisions for losses not showing in the Accumulated Appropriations for losses put into their balance sheet;

2. Record the value of their investments at the least of their amortized value or of their market value.

In the Caisses populaires, investments are usually recorded at book value. Furthermore, the Caisses populaires scarcely use the technique of the specific reserves for losses on loans and have not set up any reserves for losses on loans as provided by income tax.

This comparison clearly establishes

1. That the general reserves of the Caisses populaires are not exaggerated and that the general reserves must continue to be developed. The White Paper does not prescribe anything in this respect;

2. That the Caisses populaires will have to create, out of their future revenue, reserves for losses.

APPENDIX 8

SMITH, ANGLIN, LAING, WELDON & COURTOIS

ADVOCATES, BARRISTERS & SOLICITORS

May 29, 1970.

Roland Breton, Esq.,
Executive Secretary,
Senate Committee on Banking,
Trade and Commerce,
Parliament of Canada,
Ottawa, Ontario.

Re: Brief by the Canadian Art Museum
Directors Organization
Our file 181-B-56

Dear Sir:

Further to the request made of us at the hearing on May 13th, 1970, before your Committee, of the Brief on the White Paper proposals for tax reform by the Canadian Art Museum Directors Organization, we take pleasure in forwarding herewith twenty copies of a summary of the requests for tax reform contained in this Brief.

I wish to inform the Committee that at its annual meeting held in Charlottetown, P.E.I. on May 28th, 1970, The Canadian Museum Association passed a resolution giving its full support to the Brief which we presented to your Committee on behalf of the Canadian Art Museum Directors Organization.

We also enclose, in answer to the Committee's request voiced by Senator Phillips, the following documents explaining the recent United States legislation relating to the deductibility of gifts to museums:

1. a copy of the United States Tax Reform Act of 1969, identified as Public Law 91-172. We particularly draw the Committee's attention to Section 201 (a) and (g) adding Internal Revenue Code section 170 (b)(1)(D) and (e);

2. a book entitled "Explanation of Tax Reform Act of 1969" published by the Commerce Clearing House Inc. We particularly draw the Committee"s attention to paragraphs 1276 and 1277 thereof;

3. a xerox copy of a publication by American City Bureau/Beaver Associates, 645 North Michigan Ave. Chicago, entitled "The Tax Reform Act of 1969 and Charitable Contributions" which we obtained from the American Museum Association. We particularly draw the Committee's attention to Part I, paragraphs 1, 2 and 3;

4. a copy of a Release from the American Museum Association summarizing the new legislation relating to gifts to museums. A copy of this Release was left with the Chairman of your Committee at the hearing.

Our understanding of the recent United States legislation is that there is no taxation of capital gains on gifts of works of art to qualified museums and that these gifts are deductible at their fair market value from the donor's income to the extent of 30% of his adjusted gross income with a five-year carry over option up to the same limit. The deductibility of cash contributions is subject to a maximum of 50% of the donor's adjusted gross income.

I take this opportunity of thanking the Committee on behalf of CAMDO for the excellent hearing we received and the interest which the Committee showed in the problems facing [redacted] museums.

Yours respectfully,

Charles Gonthier

CDG:jg
Encs.

The Tax Reform Act of 1969 includes a number of provisions affecting charitable contributions. As with any new law, some of these provisions are unclear and are still to be "interpreted." However, the following outlines the major provisions of the Act concerning gifts to churches, schools, hospitals and other "publicly supported" agencies. The new laws regarding contributions to these "public charities" sometimes differ from those governing "private foundations" and "other charities." In practice, therefore, donors should obtain the advice of an attorney or tax consultant experienced in these matters to determine the exact tax ramifications of their gift.

PART I. GIFTS OF MONEY AND APPRECIATED PROPERTY

1. **Cash Contributions.** The Tax Reform Act increases the 30% deduction ceiling to a maximum of 50% of an individual's adjusted gross income for gifts of money, effective January 1, 1970. The five year carryover continues to be available for "excess" 50% gifts; however, the unlimited charitable deduction has been eliminated by a gradual program during the period from 1970 through 1974. In 1970, the unlimited deduction cannot reduce a donor's income after other itemized deductions to less than 20% of his adjusted gross income. This percentage increases ratably (6% a year) between 1970 and 1974 to 50% of adjusted gross income by 1975.

2. **"Ordinary Income Property" Contributions.** Examples of "ordinary income property" are: inventory, Code Sec. 306 stock (stock acquired in a nontaxable transaction which is treated as ordinary income when sold), works of art, books, letters and memoranda, given by the person who prepared them. Under the prior law, the allowable deduction was determined by the fair market value of the property. Effective January 1, 1970, a taxpayer's allowable deduction is limited to a cost basis of the property donated. An individual's deduction ceiling for gifts of ordinary income is 50% of his adjusted gross income.

3. **Personal Property Contributions.** Tangible personal property contributions usually include the giving of such items as antiques, books and works of art. If the item has been held by the donor for less than six months, the tax deduction is limited to the property's cost value. However, if the property has been held by the donor for more than six months and if the use of the property is related to the recipient institution's function, then the tax deduction allowed is equal to the full present fair market value of the property. An example of a contribution meeting the "related" requirement would be the gift of a painting to an art museum. If the property has been held by the donor for more than six months but the gift is unrelated to the donee's exempt function, the donor can only deduct an amount equal to the cost of the property plus one-half the appreciation. This law is effective January 1, 1970.

4. Real Estate. If the real estate has been held by the donor less than six months, the tax deduction is limited to the property's cost. If the real estate has been held for more than six months by the donor, the fair market value of the property is allowed for the tax deduction. Therefore, there is no capital gains tax on the appreciation. For gifts of long-term appreciated real estate the deduction ceiling remains at 30% of adjusted gross income unless the donor elects to take the unrealized appreciation into account for tax purposes; then the ceiling is 50%.

5. Securities. For securities held by the donor less than six months the tax deduction is limited to the cost value of the securities. This is effective as of January 1, 1970. If the securities have been held by the donor for longer than six months the donor is still allowed a tax deduction equal to the full market value of the securities. Similarly to real estate, gifts of long-term appreciated securities retain a ceiling on deductibility of 30% gross income unless the donor elects to take the unrealized appreciation in value into account for tax purposes; then the ceiling is 50%.

When a donor sells property to a charitable organization at a price less than its fair market value, this is usually termed a bargain sale. Under the new law, the cost (basis) of the property must be allocated between the portion of the property "sold" and the portion "given" to charity, based on the fair market value of each portion. For example, if an

individual (or corporation) sold to an exempt organization securities for $10,000 which had a fair market value of $20,000, he would declare a gain of $5,000 on the sale of a capital asset and would take a $10,000 charitable contributions deduction. This law affects bargain sales made after December 19, 1969.

PART II. CHARITABLE REMAINDER TRUSTS

1. **The Annuity Trust and the Unitrust.** Charitable remainder trusts are created when a donor pays a charitable organization a given sum (in the form of cash, securities, or other property) and in turn the organization pays a specified annual income to the donor for life. Upon the death of the donor, or at the end of a specified number of years, the remaining portion of the trust is turned over to the institution. This basic plan can be modified in many ways to suit the needs of the donor, including provision for the income to be provided for specific heirs before the trust is turned over to the institution.

The Tax Reform Act of 1969 limits the availability of income, estate and gift tax deductions to two types of trusts—the annuity trust and the unitrust.

The **Annuity Remainder Trust** specifies in dollar terms the amount of the annuity which is to be paid annually to the recipient of the income. The specified annual income must be at least five percent of the initial net fair market value of the transferred property.

The Unitrust Remainder Trust specifies that the income to be received by the donor (or any person designated by the donor to receive it) is to be based on a fixed percentage of the net fair value of the trust's assets as determined each year. As an alternative, a qualified charitable remainder unitrust can provide that if trust income for the year is insufficient that only the trust income need be paid out, and the deficiency picked up in subsequent years.

Charitable contribution deductions are denied for gifts of remainder interest in all other types of trusts, except if the grantor gives all the interests in a trust to charity. No charitable contribution deductions are allowed for the unitrust or annuity trust where the assets transferred to the trust do not have an ascertainable market value (e.g., real estate, closely-held corporate stock) unless an independent trustee is the sole party responsible for making the annual determination of value.

A charitable deduction for the gift of the unitrust or annuity trust is allowed when the trust is created. The income received by the donor from the trust is taxed. Under both the unitrust and the annuity trust the amount paid to the income beneficiary retains the character it had in the trust (that is, ordinary income, capital gain, other income, or distribution of principal) and, therefore, is taxed accordingly. For purposes of the income and gift tax charitable deductions the new rules apply to transfers in trust made after July 31, 1969.

2. **Short Term Charitable Income Trusts.** In the past, a short term charitable trust was defined as one in which a trust was set up and the income from it was paid to a specified charitable organization for at least two years, but then the trust principal was returned to the donor. The new tax reform law repeals the two-year charitable trust rule, and taxes the donor on the income paid to a charity by such an arrangement. To avoid income tax to the donor, the trust term has to be at least 10 years. This provision is effective with respect to transfers in trust made after April 22, 1969.

The Act also imposes strict requirements for allowing income tax charitable deductions for income interests in trusts where there are non-charitable remaindermen. Deductions are permitted for an income interest in trust only where the grantor is taxed on the trust's income, and the income interest is payable in the form of a guaranteed annuity or a fixed percentage of the fair market value of the trust property determined annually. Deductions are allowed, however, where the donor has given the income interest to one charity and the remainder interest to another. These provisions apply to transfers of property made to a trust after July 31, 1969.

3. **Pooled Life Income Contracts.** A pooled fund is a trust set up by a public charity to which an individual transfers property and the donor or his designated beneficiaries receive an income annually for life based on the average net yield earned yearly by the

institutions pooled investment funds. The public charity, therefore, has a remainder interest in the property transferred to it.

Under the new law it would seem that the life income pooled fund of the institution can contain only life income contract gifts and not be mixed in with the institution's endowment. The fund cannot invest in securities whose income is tax-exempt. No donor or income beneficiary can be a trustee of the fund, however, the charity does not have to act as trustee of the fund. Each person who has an income interest in the fund must be paid an annual amount of income based on the fund's rate of return. In other words, the trust cannot accumulate income for any beneficiary.

We would be pleased to furnish you with additional information about philanthropic gifts and discuss with you and your advisors the most advantageous way to make them. Please call or write.

TABLE I

GIFT PROGRAMS FOR SINGLE PERSONS

Adjusted Gross Income	Amount of Gift	INCOME TAX SAVINGS Resulting from Gift		Net Cost of Gifts to Donor		Percent of Gift Absorbed by the Government	
		1970	1971	1970	1971	1970	1971
$ 8,000	$ 800	$ 180	$ 176	$ 620	$ 624	23	22
10,000	1,000	256	250	744	750	26	25
15,000	1,500	507	494	993	1,006	34	33
20,000	2,000	842	821	1,158	1,180	42	41
25,000	2,500	1,234	1,203	1,266	1,298	49	48
30,000	3,000	1,580	1,541	1,420	1,460	53	51
40,000	4,000	2,255	2,200	1,745	1,800	56	55
50,000	10,000	5,995	5,848	4,005	4,153	60	58
75,000	15,000	9,835	9,594	5,165	5,406	67	64
100,000	20,000	13,962	13,621	6,038	6,380	70	68
150,000	30,000	21,525	21,000	8,475	9,000	72	70
250,000	50,000	35,875	35,000	14,125	15,000	72	70

This table assumes no dependents and $2,000 of itemized deductions, other than contributions; and the adjusted gross income is a combination of compensation plus investment income.

This table shows only federal income tax savings. The net cost to the donor will be even less in cases where estate tax or state or local income tax savings are also achieved.

TABLE II

GIFT PROGRAMS FOR MARRIED PERSONS FILING A JOINT RETURN

Adjusted Gross Income	Amount of Gift	INCOME TAX SAVINGS Resulting from Gift		Net Cost of Gifts to Donor		Percent of Gift Absorbe[d] by the Government	
		1970	1971	1970	1971	1970	1971
$ 8,000	$ 800	$ 136	$ 132	$ 664	$ 668	17	17
10,000	1,000	195	190	805	810	20	19
15,000	1,500	338	330	1,162	1,170	23	22
20,000	2,000	513	500	1,488	1,500	27	25
25,000	2,500	738	716	1,762	1,784	30	29
30,000	3,000	1,046	1,016	1,955	1,984	35	34
40,000	4,000	1,707	1,662	2,293	2,338	43	42
50,000	10,000	4,797	4,672	5,203	5,328	48	47
75,000	15,000	8,282	8,078	6,718	6,922	55	53
100,000	20,000	12,028	11,730	7,972	8,270	60	59
150,000	30,000	19,701	19,216	10,300	10,784	66	64
250,000	50,000	35,829	34,954	14,171	15,046	72	70

This table assumes the couple has 2 dependents and $2,000 of itemized deductions, other than con- tributions; and the adjusted gross income is a combination of compensation plus investment income.

This table shows only federal income tax savings. The net cost to the donor will be even less in cases where estate tax or state or local income tax savings are also achieved.

TABLE III

GIFT PROGRAMS FOR CORPORATIONS

Amount of Gift	Income Tax Savings Resulting From Gift		Net Cost To Corporation	
	1970	1971 & thereafter	1970	1971 & Thereafter
$ 5,000	$ 2,460	$ 2,400	$ 2,540	$ 2,600
10,000	4,920	4,800	5,080	5,200
25,000	12,300	12,000	12,700	13,000
50,000	24,600	24,000	25,400	26,000
100,000	49,200	48,000	50,800	52,000
250,000	123,000	120,000	127,000	130,000
500,000	246,000	240,000	254,000	260,000

ssuming the corporation to have taxable income in excess of $25,000.

AMERICAN ASSOCIATION OF MUSEUMS
AAM BULLETIN

WASHINGTON REPORT
PLACEMENT BULLETIN
CLASSIFIED ADS

January 2, 1970

WASHINGTON REPORT:

MUSEUMS WIN ON TAX BILL!

The House-Senate Conference Committee completed its action on H.R. 13270, the Tax Reform Act of 1969, and on December 21, 1969, Congress adopted it by overwhelming majorities in both Houses. At the time this newsletter went to print, the bill was on President Nixon's desk awaiting his signature, or veto (unlikely).

Appreciated Value of Donated Personal Properties will not be taxed in most cases involving museums. Note, however, the cases in which tax consequences are applied on appreciated properties:

1. Appreciation is taken into account in the case of gifts to a private foundation other than an operating foundation and other than a private foundation which within one year distributes an amount equivalent to the total amount of gifts of appreciated property.

2. Appreciation is taken into account in the case of property (such as inventory or works of art created by the donor) which would give rise to ordinary income if sold.

3. Appreciation is taken into account in the case of gifts of tangible personal property (such as paintings, art objects, and books not produced by the donor), except in the case of such gifts which would result in capital gain if the property were sold and where the use of the property is related to the exempt function of the donee.

4. Appreciation is taken into account in the case of gifts of future interests in property unless a capital gain would result if the property were sold.

These amendments relating to charitable gifts generally apply to contributions paid after December 31, 1969, except that in the case of a gift of a letter or memorandum or similar property, the charitable contribution amendments are to apply to contributions paid after July 25, 1969.

Charitable Contribution Limit is raised to 50% of a taxpayer's contribution base (generally adjusted gross income) in the case of donations to publicly supported charities, private operating foundations (these two categories cover almost all museums), and private non-operating foundations which distribute such contributions within 2½ months following the year of receipt. This 50% limitation provides for a limit of 30% on gifts of appreciated property, and the remaining 20% can be donated in cash or non-appreciated property.

The Excise Tax on Private Foundations Reduced from 7.5% to 4%. The conference language provides for a tax of 4% of the net investment income of each foundation for the taxable year. Unfortunately, this is interpreted to apply to all private foundations, operating or non-operating.

ARTS & HUMANITIES FOUNDATIONS: President Nixon asked Congress to extend the legislation creating the National Foundation on the Arts and Humanities for an additional three years beyond its present termination date of June 30, 1970. He asked that Congress fund $40,000,000 for the National Foundation in Fiscal Year 1971 (begins July 1, 1970) to be made available from public ($35,000,000) and private ($5,000,000) sources.

In his press release of December 10, 1969, the President stated a major justification for this request, "We would be able to provide some measure of support to hard-pressed cultural institutions, such as museums and symphony orchestras, to meet the demands of new and expanding audiences."

Congressional hearings on authorization bills for this purpose will be held during the last week of January, 1970, when joint hearings between the House and Senate are scheduled to hear from governmental witnesses such as Nancy Hanks (Chairman for the Arts) and Barnaby Keeney (Chairman for the Humanities). Public testimony is being scheduled for the first week in February, 1970 before Congressman John Brademus (D.-Ind.). Senator Claiborne Pell (D.-R.I.) has introduced S. 3215 for this purpose, and Sen. Jacob Javits (R.-N.Y.) has introduced a similar bill, S. 3238. Interested parties may write:

Senator Claiborne Pell, *Chairman*
Special Subcommittee on the Arts and Humanities
Committee on Labor and Public Welfare
U. S. Senate
Washington, D. C. 20510

and Congressman John Brademus, *Chairman*
Select Subcommittee on Education
Room 2134, Rayburn House Office Building
Washington, D. C. 20515

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SUMMARY OF REQUESTS BY
CANADIAN ART MUSEUM DIRECTORS ORGANIZATION
IN ITS BRIEF ON THE WHITE PAPER PROPOSALS FOR TAX REFORM

1. Removal of the present limitation of 10% of net income so as to allow full deductibility of gifts to private and municipal museums which are recognized as charitable organizations.

2. Gifts to museums which are recognized charitable organizations should be deductible from the donor's income at fair market value or at cost price whichever is greater at the time of gift.

3. Gifts of property, securities and tangible personal property appropriate to the exempt function of the donee which is a recognized charitable organization should not be treated as giving rise to a capital gain.

4. The minimum valuation of $500 proposed in Section 3.23 of the White Paper in connection with capital gains on works of art amongst others should be increased to $5,000 and make applicable to family heirlooms and family portraits.

5. In the event of a capital gain on works of art, the taxpayer should be allowed to elect to be taxed on that portion of the capital gain that the length of time the taxpayer owns the work of art after valuation day bears to the entire period of his ownership.

6. The special provisions proposed in Section 3.26 of the White Paper relating to losses on paintings, sculpture, jewellery, coin and stamp collections should not be adopted but losses on this type of property as well as works of art in general should be treated in the same manner as losses on any other property, that is they should be deductible from capital gains realized on any type of property with the same carry back and carry forward options as are recognized for other property.

7. Works of art should be excluded from the proposal in Section 3.40 of the White Paper providing for a deemed capital gain in the event that the owner ceases to reside in Canada.

8. Bequests of works of art to museums recognized as charitable organizations made subject to a right in favour of the deceased's children to retain their use during their lifetime should not be subject to estate taxes.

9. Family heirlooms and family portraits should be exempt from estate taxes.

APPENDIX 9

The Canadian Institute of Chartered Accountants
L'Institut Canadien des Comptables Agréés

June 25, 1970

The Honourable Salter A. Hayden
Chairman
Standing Senate Committee on
Banking, Trade and Commerce
Ottawa, Ontario

Dear Senator

When the representatives of the Taxation Committee of the Canadian Institute of Chartered Accountants appeared before your committee on June 11, Senator Phillips (the acting chairman) requested that I write to you giving the views of the C.I.C.A. Taxation Committee on a modified form of dividend tax credit outlined by him.

As we understood the proposal, its essential elements were that the form of dividend tax credit presently contained in the Income Tax Act be modified as follows:

(a) The dividend tax credit would only be available to the extent dividends were paid out of income that had borne Canadian corporate tax;

(b) Where the dividend tax credit was greater than the tax otherwise payable, the taxpayer be entitled to a refund; and

(c) The rate of dividend tax credit be increased.

It should be emphasized that we understood the proposal was to tax dividends originating only from profits that had borne Canadian tax in a more favourable manner and, consequently, dividends paid by the Canadian corporation that originated from depletion allowance or from dividends received from foreign subsidiaries would not qualify for the dividend tax credit proposed.

My committee has reviewed this proposal and, confirming my initial comments made before your committee has concluded that except for variations resulting from

(a) the absence of the "gross-up" feature, and

(b) any difference in rate imposed by the absence of the "gross-up" feature

it is reasonably similar in its general thrust to the proposal contained in the White Paper for widely-held Canadian corporations and to the recommendation we made in paragraph D.10 of our submission for all Canadian corporations other than those exercising the partnership option.

It has the same basic advantages of providing an incentive towards Canadian ownership of Canadian shares and giving some recognition to that portion of corporate tax that may be borne by shareholders. By eliminating the "gross-up" feature it slightly reduces the complexity to individual shareholders at the cost of some reduced progressivity. Otherwise, the proposal carries with it the difficulties, complexities and advantages inherent in any system that relates the credit available to the shareholders to the Canadian tax paid by the corporation.

Attached as appendices "A" and "B" are two very simple illustrations comparing the present dividend tax credit system (with a 30% rate), the modification suggested by Senator Phillips (with the same 30% rate), and the gross-up and credit method proposed in the White Paper for widely-held corporations. (A dividend tax credit at the rate of 30% was selected solely on the basis that, for a shareholder with a 40% marginal rate of tax, the net cash proceeds are the same as under the "gross-up" procedure in those cases where sufficient corporate tax has been paid.)

Appendix "A" assumes that before tax income per financial statements and income for tax purposes are equal and the corporate rate is 50%. The dividend is fully covered for creditable tax and payment out of taxed income. The net cash received by shareholders at various marginal rates on a dividend of $1,000 can be summarized as follows:

	1	2	3
TAXPAYER'S MARGINAL RATE	DIVIDEND TAX CREDIT AT THE RATE OF 30%	MODIFIED DIVIDEND TAX CREDIT (Note 1)	GROSS-UP AND CREDIT TO 50% OF CORPORATE TAX
20%	$1,000(Note 2)	1,100(100%)	1,200(100%)
30%	1,000	1,000(91%)	1,050(88%)
40%	900	900(82%)	900(75%)
50%	800	800(73%)	750(63%)

Note 1 The modified dividend tax credit is also at the rate of 30% but only applies to the extent the dividend originated from income that had borne Canadian tax. Refunds would be made where appropriate.

Note 2 The only difference between the existing type of dividend tax credit and the modified version in this illustration appears in the 20% bracket and results from the restriction on refunds.

Note 3 The percentages shown in brackets in columns 2 and 3 reflect the relationship in after-tax income in the various tax brackets assuming the net after-tax income to the 20% bracket shareholder equals 100.

This summary demonstrates that the dividend tax credit technique provides less progressivity than the gross-up and credit method and also that there is little difference between the existing type of dividend tax credit and the modification where sufficient corporate tax has been paid to cover the dividend.

Appendix "B" assumes that income for tax purposes is significantly lower than before tax income per financial statements. The dividend is not covered for creditable tax and part of it is paid out of income that has not borne tax. (In the illustration the difference arises from excess of capital cost allowance over depreciation charged in the financial statements but it could equally arise from a dividend from a foreign subsidiary that would be exempt under

Section 28(1)(d) or from other non-taxable financial income.) The net cash received by shareholders at various marginal rates on a dividend of $1,000 can be summarized thus:

	1	2	3
TAXPAYER'S MARGINAL RATE	DIVIDEND TAX CREDIT	MODIFIED DIVIDEND TAX CREDIT	GROSS-UP AND CREDIT TO 50% OF CORPORATE TAX
20%	$1,000	987.50(100%)	1,050 (100%)
30%	1,000	887.50(90%)	918.75(88%)
40%	900	787.50(80%)	787.50(75%)
50%	800	687.50(70%)	656.25(63%)

This summary again illustrates the greater progressivity of the gross-up and credit method and it shows the significant variation between the existing type of dividend tax credit and the modification suggested where dividends are paid out of non-taxed income.

Appendix "B" (which as already stated deals with a very simple situation) also demonstrates that the corporation must maintain a running record of its "taxed income" in order that it may advise its shareholders as to dividend tax credit entitlement. This is analagous to the requirement under the White Paper proposal that the corporation maintain a running record of its "creditable tax" but it may be more difficult to apply, particularly for interim dividends. There is a certainty about tax instalments paid that is lacking in estimates of income.

It would also be necessary for the corporation to provide shareholders with information to complete their tax returns. Using the data in Appendix "B", under the modified dividend tax credit proposal, the minimum advice required by the shareholder would be:

Amount of dividend	$ 1,000
Amount eligible for dividend tax credit at 30%	$ 625
Amount taxable as ordinary income	375

Under the gross-up and credit procedure, it would be:

Include in your income	$ 1,312.50
Claim credit for	312.50
Amount of dividend	$ 1,000.00

As already stated, we believe the modified dividend tax credit suggestion has essentially the same complexities and problems as are common to all proposals for integration of personal and corporate taxes. It is unnecessary to discuss these problems again in detail but we believe the following major criticisms and our brief comments thereon may be of interest.

1. Lack of creditable tax because of timing differences

    This problem (which is illustrated in Appendix "B") usually results from the excess of capital cost allowance claimed over depreciation recorded in the financial statements.

    Although it can be argued that the acceleration of capital cost allowance is intended to provide for expansion of corporate assets and not to permit payment of dividends, we believe that taxation of such dividends at full rates as ordinary income is not warranted. Accordingly, we recommend that dividends of this nature be treated in the hands of individual taxpayers as capital gains (i.e. only 50% of the gain would be included in income). This suggestion is referred to in paragraphs D.19 and D.23(b) of our submission to your committee.

2. Natural resource industries

    There could also be a deficiency of creditable tax where dividends were paid out of depletion allowance or other resource industry incentive legislation.

Here again, we recommended similar treatment to that described in 1 above. Paragraphs D.19, D.23(b) and E.35 of our submission deal with this aspect of creditable tax.

3. Dividends from foreign subsidiaries

This is an important policy issue, involving as it does, the possibility that tax credits (and consequently refunds) might be granted in respect of income on which foreign taxes only had been paid. However, many Canadian based international companies with significant Canadian operations are likely to find that the combination of Canadian taxes paid plus the proposed "flow-through" of foreign withholding taxes is adequate to provide full creditable tax on dividends paid. The recommendation contained in paragraph D.23(b) of our submission would provide alleviation in other cases.

4. Intercorporate dividends

Special provision would be required for intercorporate dividends. This was also dealt with in paragraphs D.44 to D.48 and in paragraph D.23(b) of our submission.

5. "Bias" against Canadians investing in growth corporations

The "bias" against growth companies implicit in the integration proposals would be substantially reduced under our suggestion that dividends not carrying creditable tax be treated as capital gains. The need for some similar provision exists with the modified tax credit proposal.

In conclusion

(a) we consider the modified dividend tax credit is superior to the present dividend tax credit as a means of partial integration of corporate and shareholder taxes;

(b) we consider the gross-up and credit procedure to be superior to the modified dividend tax credit as a partial integration technique;

(c) we doubt whether the variation from the progressive rate structure inherent in the modified dividend tax credit can be justified on the grounds of greater simplicity and better shareholder comprehension; and

(d) we recognize that the proposal put forward by Senator Phillips would in many ways be similar to our own proposal and, consequently, it is a suggestion we would not oppose.

If we can provide any further assistance to your committee, we would be happy to do so.

Yours very truly

W. E. Goodlet
Chairman, Taxation Committee
Canadian Institute of
Chartered Accountants

APPENDIX "A"

COMPARATIVE TAX COSTS AND RETURN TO SHAREHOLDERS

ON DIVIDEND PAYMENT

(FINANCIAL INCOME EQUAL TO TAXABLE INCOME)

EXPLANATIONS AND ASSUMPTIONS

1. Corporate tax rate is 50%.
2. Corporation pays a dividend of $40,000 with shareholders having the marginal rates indicated receiving a dividend of $1,000.
3. The columns "creditable tax" and "taxed income" represent the running record that must be maintained by the corporation so that shareholders may be advised of their tax credit entitlement for the "gross-up and credit" procedure or their dividend tax credit entitlement for the modified dividend tax credit system proposed.
4. The dividend tax credit rate is assumed to be 30%.
5. The three columns under each marginal tax rate represent
   - (1) existing dividend tax credit method
   - (2) modified dividend tax credit method
     - as described in paragraph 2 of the accompanying letter
   - (3) 50% gross-up and credit
     - the White Paper proposal for widely-held corporations.

CORPORATE

	SURPLUS	CREDITABLE TAX	TAXED INCOME
Net income	$ 100,000		
Taxes payable	50,000	25,000	
	50,000	25,000	50,000
Dividend	40,000	20,000	40,000
Balance	$ 10,000	5,000	10,000

INDIVIDUAL SHAREHOLDER

Marginal rate	20% (1)	20% (2)	20% (3)	30% (1)	30% (2)	30% (3)	40% (1)	40% (2)	40% (3)	50% (1)	50% (2)	50% (3)
Tax	200	200	300	300	300	450	400	400	600	500	500	750
Credit	200	300	500	300	300	500	300	300	500	300	300	500
Taxes payable (refundable)		(100)	(200)			(50)	100	100	100	200	200	250
NET CASH TO SHAREHOLDER	1,000	1,100	1,200	1,000	1,000	1,050	900	900	900	800	800	750

APPENDIX "B"

COMPARATIVE TAX COSTS AND RETURN TO SHAREHOLDERS

ON DIVIDEND PAYMENT

(FINANCIAL INCOME DIFFERS FROM TAXABLE INCOME)

EXPLANATIONS AND ASSUMPTIONS

As in Appendix "A"

CORPORATE	SURPLUS	TAXABLE INCOME	CREDITABLE TAX	TAXED INCOME
Net income	$ 100,000	100,000		
Excess of capital cost allowance over depreciation booked		50,000		
Taxable income	100,000	50,000		
Taxes payable	25,000	25,000	12,500	
Deferred taxes	25,000			
	50,000	25,000	12,500	25,000
Dividend	40,000		12,500	25,000
	$ 10,000			

INDIVIDUAL SHAREHOLDER

Marginal rate	20% (1)	20% (2)	20% (3)	30% (1)	30% (2)	30% (3)	40% (1)	40% (2)	40% (3)	50% (1)	50% (2)	50% (3)
Tax	200.00	200.00	262.50	300.00	300.00	393.75	400.00	400.00	525.00	500.00	500.00	656.25
Credit	200.00	187.50	312.50	300.00	187.50	312.50	300.00	187.50	312.50	300.00	187.50	312.50
Taxes payable (refundable)		12.50	(50.00)		112.50	81.25	100.00	212.50	212.50	200.00	312.50	343.75
NET CASH TO SHAREHOLDER	1,000.00	987.50	1,050.00	1,000.00	887.50	918.75	900.00	787.50	787.50	800.00	687.50	656.25

APPENDIX 10

THE CANADIAN MEDICAL ASSOCIATION L'ASSOCIATION MÉDICALE CANADIENNE

July 6, 1970.

Senator Salter A. Hayden,
Chairman,
Standing Senate Committee on Banking,
Trade and Commerce,
Room 1124, West Memorial Building,
Wellington st Lyon Street,
Ottawa 4, Ontario.

Dear Senator Hayden:

When the Canadian Medical Association made its submission to your Standing Committee on Banking, Trade and Commerce on May 14th, members of the Committee asked the Association to suggest rules which should apply relative to the claiming of expenses for attending conventions.

Our Board of Directors at a recent meeting approved the following rules as being reasonable criteria for the claiming of expenses in attending conventions:

RULES FOR CONVENTION EXPENSES

Taxpayers should be allowed to claim as an expense, for tax purposes, reasonable travelling and maintenance costs actually incurred in attending conventions provided that:

1. The conventions are sponsored by recognized organizations or associations.

2. The convention agenda includes a business meeting of the members of the sponsoring organization, and other sessions relating to the taxpayer's professional or business interests.

3. Facilities are available so that business is conducted in, or translated into, a language in which the taxpayer is fluent.

Senator Salter A. Hayden July 2, 1970

4. The taxpayer's satisfactory attendance be verified by the sponsoring organization.

5. If a taxpayer claims expenses for more than one convention in any one year, at least one of these must be a convention held within Canada.

6. Recognized organizations or associations be asked to appoint ad hoc committees as the occasion arises to assist the department in interpreting the regulations and hearing appeals.

We hope that this will be of assistance to your Committee.

Yours sincerely,

THE CANADIAN MEDICAL ASSOCIATION

B. E. Freamo,
Acting General Secretary.

APPENDIX 11

Canadian
Pulp and Paper
Association

Supplementary information with respect to

Submission on Proposals for Tax Reforms

CANADIAN PULP AND PAPER ASSOCIATION

SUPPLEMENTARY INFORMATION ON

PROPOSALS FOR TAX REFORM

JUNE 1970

The brief of the Canadian Pulp and Paper Association on the White Paper "Proposals for Tax Reform" was presented to the House Standing Committee on Trade, Finance and Economic Affairs on May 19, 1970, and to the Senate Standing Committee on Banking, Trade and Commerce on June 4, 1970. During these hearings several questions were posed by members on which it was agreed a supplemental submission might be filed. This memorandum covers our answers to these questions.

The original brief was prepared under some pressure to meet the deadlines set by the Committees. It contained alternative proposals for tax reform designed to stimulate the economy, broaden the tax base, and provide sufficient revenues to governments to meet requirements and also to distribute the tax burden more equitably. In the original brief the financial effects of our proposals were estimated in very general terms, but we have continued to work on these calculations and find that our proposals, if staged over a five year period, are likely to produce reasonable balance each year between government needs and revenues. These estimates are set out in this memorandum, in the answer to Question No. 1.

Some of the other answers deal with technical points which are more easily provided in writing, than in an oral presentation.

QUESTION NO. 1 Explain how the Canadian Pulp and Paper Association's proposals would work out over the next five years.

To indicate how the Canadian Pulp and Paper Association's proposals would affect gross national product and government revenues, calculations based on a reasonable schedule of reforms are given in the attached tables. The staging used in the example is only one of a number that could be implemented, and alternative schedules could be tested by the Committee. Calculations showing the same information for the present tax system and the system proposed in the White Paper are also given.

According to the Organization for Economic Cooperation and Development, the growth rate of the Canadian economy from 1958 to 1968 was 4.7 per cent per year in real terms. This is substantially below the potential of the economy, and below the rate of a number of European countries. It is generally believed that the White Paper proposals will decrease the rate of growth. For purposes of this analysis a 4.5 per cent rate has been assumed should the White Paper be adopted. On the other hand, a tax system designed to foster growth could result in a rate of 1.5 percentage points above this - that is, 6.0 per cent per year.

For illustrative purposes, data for 1969 have been chosen as a base. Estimated tax revenues based on data for the first three quarters as given in the 1970 budget are as follows:

Personal Income Taxes	$8.239 billion
Corporation Income Taxes	2.650
Withholding Taxes	.255
	11.144 billion
Indirect Taxes	10.961
Investment Income	2.630
	13.591
TOTAL	24.735
Less - Federal Surplus	.355
Revenue needs	24.380

In the Canadian Pulp and Paper Association's example the plan would be announced at once. Personal income taxes would be reduced by $.70 billion, $.67 billion and $.30 billion in the first three years. The planned reduction of the corporation tax rate would be announced but the reductions would take effect in the third and fourth years. In the first year the corporation tax would be increased by $.20 billion, as a result of the elimination of the low rate on the first $35,000 income net of providing some form of subsidy to assist small business. The rate of growth of gross national product is assumed to be 5.4 per cent in the first year and 6.0 per cent thereafter. It is assumed that personal income taxes would increase by 1.5 per cent for every one per cent increase in gross national product and that other taxes would increase in proporation to G.N.P.

A growth rate of 4.7 per cent per year has been used to illustrate the effect of the present tax system. For the White Paper proposals, the growth rate used was 4.5 per cent and the changes have been phased in over the period as outlined in the White Paper. Because of the increase in the rate of progression that will result from the White Paper proposals, it is assumed that personal income taxes will increase by 1.8 per cent for every one per cent increase in G.N.P.

Estimated gross national product and tax revenues under the three systems, assuming no change in prices, would be as follows:

	G N P			TOTAL TAX REVENUE		
	Present	White Paper	C.P.P.A.	Present	White Paper	C.P.P.A.
	billion	1969	dollars	billion	1969	dollars
1969	77.9	77.9	77.9	24.38	24.74	24.74
1970	81.6	81.4	82.1	25.72	25.99	25.70
1971	85.4	85.1	87.0	27.14	27.84	26.82
1972	89.4	89.0	92.3	28.64	29.84	28.20
1973	93.6	93.0	97.8	30.21	32.00	29.96
1974	98.0	97.2	103.7	31.87	34.32	32.03

The C.P.P.A. proposals would provide an increase in total tax revenue each year, enabling government services to be maintained. The White Paper proposals show sharply rising government revenues, but a slower rate of growth of the economy. The result would be an increase

in the percentage of G.N.P. taken in taxes from the present level of 31.8 per cent to 35.3 per cent in five years' time. Under the C.P.P.A. proposals, on the other hand, tax revenue in the fifth year would be 30.9 per cent of G.N.P., a lower percentage than at present, but the amount of revenue in the fifth year would be equal to that provided by the present system.

While it has not been possible for the Association to carry out exhaustive studies or construct an elaborate economic model to test various policy alternatives, the calculations do suggest the proposals are feasible if staged over a relatively short period and warrant careful consideration. It is recognized, of course, that care would have to be taken to avoid actions that would cause any increase in inflationary pressures. However, insofar as our proposals would have an expansionary effect on supply, they would act to decrease inflationary pressures.

In implementing the proposals, the level of government expenditures would have to be carefully planned. The proposed method of financing assumes no increase in total government services except by means of additional taxation specifically authorized by the electorate with their full knowledge.

There is a reference in the White Paper to government revenue requirements to the effect that, "the needs of the federal and provincial governments for money to do useful and important things are so great that we cannot afford to reduce the over-all revenues from personal and corporate income tax." This statement is extremely vague, and judging by some of the questions posed by members of the Standing Committee it appears to have given rise to concern, if not confusion, as to the future development of government expenditures. Therefore it is important to understand the meaning of the words "no increase in the level of government expenditures."

Increases in government expenditures are due to four main causes:

1. To the extent that salaries and wage level in the country increases, the government will have to pay more to its employees. This condition however assumes an increase in G.N.P., and thus a more than proportionate increase in government revenue as tax collections are at least roughly proportionate to G.N.P.

2. Certain welfare programme expenditures appear to rise continually. To the extent that these rises are due to inflation, the same arguments apply as above i.e., that revenue should automatically rise correspondingly.

3. Some government programs appear to have an "overhang" expenditure feature, for example the age distribution may affect education, old age assistance, etc. Such factors should be capable of being evaluated and set forth clearly as, in effect, contingent liabilities of the government. Tax revenues should be planned for them when the programs are instituted, or in the case of programs of long standing, their priority should be re-assessed in allocating future government expenditures.

As against this factor, many social welfare programs should generate a decreased expenditure. For example, as health treatment is directed to preventative care, there should be a reduction in illness; as the various pension plans become mature, there should be a greatly reduced number of indigent aged people; as life insurance become more diffused, there is less necessity for assistance to widows, etc.

These three factors should be estimated and taken into account in fiscal planning.

4. New programs. These should be linked to revenue potential. Such programs compete in priority for tax reductions aimed at social justice i.e., equity of tax burden. Governments should be completely frank in disclosing the tax burden of new programs when they are presented to the electorate.

By identifying the exact areas where government expenditures are subject to increase, the vague feeling of oppressive demands for future revenue that is evident in the White Paper can be clarified. If it is disclosed that new taxes are required, this fact should be clearly presented and not hidden amongst measures for tax reform.

In the course of discussion of tax reform over the past few months, government spokesmen have stated that Canada must provide a level of government services to its citizens equal to that of the United States, and that as our per capita income is less than in that country, our tax rates must be higher. If we do attempt to provide the same level of government services from a lower per capita income, it follows that the services provided by the private sector will be lower than the proportionate rate based on relative incomes. There is no evidence that the Canadian population is in favour of such a division of services. Improvement of the rate of growth of the economy is, over a period of years, more effective than high per capita government expenditures in meeting the goals of society. There is justifiable concern in tax reform for a tax system which will produce increased revenue. In this respect, the central theme of the C.P.P.A. submission to the Standing Committee is that increases in the level of economic activity provide increasing additional revenues to meet government revenue needs.

A precedent for the action we suggest is provided by policies of the United States Government taken in the early 1960's to increase the rate of growth of the economy. Taxes were reduced by

$12 billion per annum over a period of four years while the budget was in deficit. Federal expenditures were also increased. The Economic Report of the President for 1969 stated, page 77,

> "First, the fiscal and monetary policy actions that were taken deliberately to influence economic activity generally worked in the right direction with effective results,"

and

> "Second, the experience of 1961-65 demonstrated that an effective fiscal policy to stimulate the economy could be carried out without adding unnecessarily to the size of the Federal budget. Since the aims of stabilization policy can be implemented either through tax changes or expenditure changes, decisions regarding Federal expenditures can be properly based on the desired allocation of resources between the public and private sectors."

ESTIMATED GROSS NATIONAL PRODUCT AND TOTAL TAX REVENUE 1969-1974
UNDER PRESENT TAX SYSTEM
Billions of 1969 dollars

	1969	1970	1971	1972	1973	1974
GROSS NATIONAL PRODUCT	77.90	81.56	85.39	89.41	93.61	98.01
Personal Income Taxes	8.12	8.69	9.31	9.97	10.67	11.42
Withholding and Corporation Taxes	2.88	3.02	3.16	3.31	3.46	3.62
Indirect Taxes and Investment Income	11.38	14.01	14.67	15.36	16.08	16.83
TOTAL TAX REVENUE	24.38	25.72	27.14	28.64	30.21	31.87
TAXES AS PER CENT OF G.N.P.	31.30	31.54	31.78	32.03	32.27	32.52

ASSUMPTIONS:

Rate of growth of G.N.P. - 4.7 per cent per annum

Tax Revenues - Estimated on basis of first 3 quarters of 1969 as given in Budget Papers 1970. Revenue reduced by $.36 billion to eliminate surplus and pro rated over-all taxes.

Personal Income Taxes increase 1.5 per cent for every 1.0 per cent increase in G.N.P.

Other taxes increase in proportion to G.N.P.

ESTIMATED GROSS NATIONAL PRODUCT AND TOTAL TAX REVENUE 1969-1974 UNDER WHITE PAPER PROPOSALS

Billions of 1969 dollars

	1969	1970	1971	1972	1973	1974
GROSS NATIONAL PRODUCT	77.90	81.41	85.09	89.00	93.01	97.20
Personal Income Tax - Basic	8.24	8.91	9.25	10.30	11.46	12.74
- Adjustment		- .35	+ .28	+ .30	+ .33	+ .35
- Estimated actual		8.56	9.53	10.60	11.79	13.09
Corporation and Withholding Tax - Basic	2.91	3.04	3.38	3.63	3.90	4.18
- Adjustment		.19	.09	.10	.10	.11
- Estimated actual		3.23	3.47	3.73	4.00	4.29
Indirect Taxes and Investment Income	13.59	14.20	14.84	15.51	16.21	16.94
TOTAL TAX REVENUE	24.74	25.99	27.84	29.84	32.00	34.32
TAXES AS PER CENT OF G.N.P.	31.76	31.92	32.72	33.53	34.40	35.31

ASSUMPTIONS:

G.N.P. growth rate 4.5 per cent.
Personal income taxes increase 1.8 per cent for each 1.0 per cent increase in G.N.P. because of higher progressivity of system.
Other taxes increase in proportion to G.N.P.
Adjustments as per White Paper, pro-rated over last 4 years.

ESTIMATED GROSS NATIONAL PRODUCT AND TOTAL TAX REVENUE 1969-1974 UNDER C.P.P.A. PROPOSALS

Billions of 1969 dollars

	1969	1970	1971	1972	1973	1974
GROSS NATIONAL PRODUCT	77.90	82.11	87.04	92.26	97.80	103.67
Personal Income Tax - Basic	8.24	8.81	8.84	8.91	-	-
- Adjustment	-	- .70	- .67	- .30	-	-
- Estimated actual	8.24	8.11	8.17	8.61	9.38	10.22
Corporation and Withholding Tax - Basic	2.91	3.07	3.47	3.68	3.71	-
- Adjustment	-	+ .20	-	- .18	- .19	-
- Estimated actual	2.91	3.27	3.47	3.50	3.52	3.73
Indirect Taxes and Investment Income	13.59	14.32	15.18	16.09	17.06	18.08
TOTAL TAX REVENUE	24.74	25.70	26.82	28.20	29.96	32.03
TAXES AS PERCENT OF G.N.P.	31.76	31.30	30.81	30.57	30.63	30.90

ASSUMPTIONS:

G.N.P. growth rate 5.4 per cent first year, 6.0 per cent thereafter.
Personal income taxes increase 1.5 percentage points for every 1.0 per cent increase in G.N.P.
Other taxes increase in proportion to G.N.P.

QUESTION NO. 2 Assuming that all of the C.P.P.A. proposals for tax reform could not be adopted at once, what would the priority be?

The answer to question number one provided a staging of the tax reforms that would meet revenue requirements while stimulating growth. In the event that all of the proposals could not be adopted, we would, for purposes of establishing priority, rank them in order of their impact on economic growth. While the proposals all have similar effects, our judgement as to their importance for stimulating economic growth is as follows:

1. Lower rate of corporate tax.

2. Full dividend tax credit.

3. Increased basic exemptions.

4. Increased employment allowances.

5. Reduction of top rate on personal income tax to 50 per cent.

QUESTION NO. 3 What criteria would you use in distinguishing tax haven abuse from what you consider acceptable accumulation abroad of "passive income?"

Passive income is defined in the White Paper as being dividends, interest, royalties and trans-shipment profits earned by a controlled foreign corporation. It is proposed to tax this income in Canada.

All international business operations have income of this kind and the object should be to stop abuse, not to create a mass of administrative problems and an extra tax burden for bona fide operations.

We would therefore recommend -

1) that, as Canada will enter into treaties with only those countries that it considers to have compatible tax systems, and as it is just those countries with which our exporters have to compete, we should accept that no passive income will arise in operations of subsidiaries in treaty states.

2) Canada is at a disadvantage compared to many exporting countries in terms of tax-free export profit treatment (DISC and W.H.T.C. in the United States; European use of tax havens) as well as distance from markets and scale of domestic operations. Tax-free trans-shipment profits should be permitted to accrue to a foreign subsidiary of a Canadian parent in respect of goods exported offshore provided the price to the subsidiary is not less than the higher of -

(a) 90% of the world delivered market price for like goods in like quantities.

(b) 10% above total direct cost plus freight and insurance to destination.

Such profits would not be passive income. The changes occurring in the U.S. law form an interesting parallel.

3) The Minister be given the power to designate any non-treaty country that is, in his opinion, underdeveloped and in need of stimulating investment, as being treated unilaterally in the same way as a treaty country.

4) All other passive income should be treated as such and taxed in Canada.

5) That the dividend tax credit granted to Canadian shareholders of Canadian companies be varied (as in the case now for the depletion allowance) depending on the average foreign source income for the preceding five years -

Under 30% of total income is foreign source income - full credit.

30% - 70% of total income is foreign source income - 50% credit.

Over 70% of total income is foreign source income - Nil credit.

QUESTION NO. 4 Explain the mechanics of the special equalization tax suggested on page 23 of the brief.

The C.P.P.A. brief recommended that the rate of tax on corporate income be kept at least as low as and preferably lower than the United States rate. It is possible that such a rate could result in a transfer of funds to a foreign government where the rate of corporate tax was higher than the Canadian rate and where only credit

for the Canadian rate was allowed. The brief suggested that, if the amounts become significant, a special equalization tax could be used to avoid such transfers. This could be done by setting the equalization tax at a rate which, when combined with the Canadian corporation tax, would be equal to the corporation tax rate in force in the recipient country. This would place the foreign investor in the same position with respect to dividends received from a Canadian corporation as if investing in his own country, while providing an incentive for investment in Canada through a lower rate of tax on earnings retained in the Canadian company. This equalization tax would be in addition to the withholding tax now in force and proposed in the White Paper.

QUESTION NO. 5 What mechanics would you suggest to allow full offset of taxes by means of a dividend tax credit?

A dividend tax credit can be used to produce the same effect as creditable tax provided it is accepted that -

1) Non-taxable items to a corporation remain non-taxable when passed on to the shareholder.

2) Corporate income differs from taxable income only through the effects of legislation in respect of non-taxable items and timing differences.

   Incentives, economic adjustment by the government and the need to maintain a competitive economic business climate are the main reasons for such differences.

3) Foreign income above certain prescribed levels would reduce or eliminate the credit.

The present form of dividend tax credit is both simpler to administer and easier to understand than the gross-up and credit of creditable tax and it gives a fair result. If, however, the principle of equivalent gross earnings represented by the net dividend to people with different marginal tax rates is favoured despite the complications and artificiality, the dividend tax credit can be used, but a proportionately higher rate has to be set if the credit itself is to be subject to tax - as is the case with creditable tax.

For a full offset of tax the government would set the rate of credit by the following calculation (the tax rate being expressed as a decimal) -

$$\text{Dividend tax credit rate} = \frac{(\text{Corporate tax rate})}{(1 - \text{Corporate tax rate}) \times 2}$$

If the dividend tax credit is to be included in income and taxed the rate is twice the above.

The credit either way can be adjusted to provide the degree of offset of taxes or stimulation to investment that is required.

EXAMPLE OF FULL OFFSET OF CORPORATE TAX BY DIVIDEND TAX CREDIT (TAXABLE)

Corporate Tax Rate	45%	50%	55%
Corporate Income	1,000	1,000	1,000
Tax	450	500	550
Net Income	550	500	450
Taxable Dividend Tax Credit (as % of Dividend)	82%	100%	122%

APPLICATION - 45% Corporate Tax Rate

Personal Tax Rate	30%	40%	50%
Dividend	550	550	550
Credit (550 x .82)	450	450	450
Taxable Income	1,000	1,000	1,000
Personal Tax	300	400	500
Credit	(450)	(450)	(450)
Net Tax	(150)	(50)	50
Cash	700	600	500

- 55% Corporate Tax Rate

Personal Tax Rate	30%	40%	50%
Dividend	450	450	450
Credit (450 x 1.22)	550	550	550
Taxable Income	1,000	1,000	1,000
Personal Tax	300	400	500
Credit	550	550	550
Net Tax	(250)	(150)	(50)
Cash	700	600	500

EXAMPLE OF FULL OFFSET OF CORPORATION
BY DIVIDENT TAX CREDIT (NON-TAXABLE)

CORPORATE DATA AS FOR PREVIOUS EXAMPLE

APPLICATION - 45% Corporate Tax Rate

Personal Tax Rate	30%	40%	50%
Dividend	550	550	550
Tax	165	220	275
Credit (550 x .41)	(225)	(225)	(225)
Net Dividend	610	555	500

- 55% Corporate Tax Rate

Dividend	450	450	450
Tax	135	180	225
Credit (450 x .61)	(275)	(275)	(275)
Net Dividend	590	545	500

QUESTION NO. 6 Taxes paid by persons in the United States and Canada receiving dividends from corporations.

From Mr. Kaplan's comments after the Committee hearing it is understood that the question on which the Committee desired an explanation was:

> "You say your industry is at a disadvantage as against the United States industry because the corporation tax rate in the United States is five percentage points lower than in Canada. It seems to me that both now with a dividend tax credit, and even more under the integration proposals, the return on a dollar investment by a United States citizen in a United States pulp and paper operation bears more corporation tax than that of a Canadian investing in a Canadian pulp and paper operation. How much corporation tax does each bear and how does withholding tax affect this if the investment is in the other country?"

This is an immensely complex question and for individuals it is further complicated by the different personal tax rate structure (it is the total tax burden not just corporation taxes that are significant); different price/earnings ratios and yields in a capital exporting country such as the United States compared with a capital importing country such as Canada; the anticipated prosperity of the industry in each country in competition with other capital seekers; and the share of the G.N.P. taken by taxes compared with domestic value of the goods and services provided by those taxes.

Attached is a sheet showing the yields and price/earnings ratios of paper companies in both countries. This indicates quite clearly that the cost of capital to the Canadian companies is higher than in the United States and the expected return to a United States investor both before and after tax on a dollar invested is lower. Also attached is a sheet showing, net of personal tax, retention of an individual in each country with incomes of $10,000 and $50,000. The only conclusion that can be drawn from this is that Canada has a need for more capital than it produces while the United States is a capital exporting country. As the capital markets are related, the price for and the risks involved on investment capital are not the same.

From the corporate point of view it is approximately the same whether a United States company invests in a pulp mill in Canada or the United States - the net effective tax rate is the U.S. rate, 48%. (Provided the capitalization is mixed debt/equity). For a Canadian company the tax rate is also the same in either case - 53.4% now in Canada and the same in the United States if 70% of net earnings are repatriated and subjected to withholding taxes. In both cases the Canadian company however pays 11% more corporation tax than its United States counterpart.

The White Paper is in error in its integration proposals in assuming major corporations are "conduits" of earnings to shareholders. They are separate decision making entities with their own costs of capital on which decisions are based. For example, in answering this question it is not practical to assess an individual's investment in a pulp and paper mill but only in a pulp and paper company. The tax effects on individuals and corporations are not the same. Our recommendation is to lower the corporate tax rate to a competitive level and if necessary offset the loss of revenue by adjusting the dividend tax credit to the equivalent creditable tax proposed in the White Paper over a period of years.

CANADIAN/U.S. CAPITAL MARKETS

COMPARISON OF YIELD & P/E RATIOS FOR PAPER COMPANIES

JUNE 15, 1968

U.S. COMPANY	P/E RATIO	YIELD	CANADA COMPANY	P/E RATIO	YIELD
Boise Cascade	31.1	4.0%	Abitibi	11.8	6.7%
Crown Zellerbach	15.6	4.7%	B.C. Forest Products	11.2	6.5%
Georgia Pacific	29.4	1.3%	Consolidated-Bathurst	6.1	13.7%
International Paper	16.1	4.1%	Crown Zellerbach (Can.)	12.5	8.0%
St. Regis	14.5	4.2	Domtar	18.1	5.3%
Weyerhauser	24.0	2.9	MacMillan Bloedel	11.7	5.9%
Unweighted Average	21.8	3.5%		11.9	7.7%
	4.6%			8.4%	

Source - Beatty Statistical Service, New York.

1969 STATISTICS

RETURN* ON NET WORTH + FUNDED DEBT

U.S.		CANADA	
Composite Forest Products -		Abitibi	5.8%
Group - High	12.0%	Consolidated-Bathurst	4.6%
- Low	6.4%	Crown Zellerbach	8.4%
U.S. Average	8.3%	Domtar	5.6%
		MacMillan Bloedel	9.3%
		Canadian Average	6.4%

* Return = Net earnings + 48% of debt interest.

U.S./CANADA
COMPARISON OF TAX EFFECTS
ON DIVIDENDS AND INCOME

PULP & PAPER COMPANY

CORPORATE PROFIT & LOSS STATEMENT

	U.S.	Canadian Now	Canadian White Paper
Income	$1,000	1,000	1,000
Corporate Tax	480	530	545
Net	520	470	455
Dividend	520	470	455
TAXPAYER EARNING $50,000 + DIVIDEND			
Marginal Rate	55%	56.65%	50%
Taxes on Other Income*	15,202	19,631	19,811
Tax on dividend	286	172	113
Total Taxes	15,488	19,803	19,924
Net Dividend	234	298	342
Net Income	$40,032	30,668	30,531
TAXPAYER EARNING $10,000 + DIVIDEND			
Marginal Rate	25%	26.78%	33.28%
Taxes on Other Income	932	1,764	1,780
Tax on dividend	130	32	-
Total Taxes	1,062	1,796	1,780
Net Dividend	390	438	455
Net Income	$9,458	8,674	8,675

* P.W. Study - New York vs Ontario Table VII

APPENDIX 12

FRANCIS, GAULEY, DIERKER & DAHLEM
BARRISTERS AND SOLICITORS

REFER TO Mr. J.J. Dierker

OUR FILE NO. 16,866

June 8th, 1970.

The Honourable Senator S.A. Hayden,
Chairman,
Senate Committee on Banking, Trade
and Commerce,
Parliament Buildings,
Ottawa, Canada.

Dear Senator Hayden:

You will recall that at the time of the Co-operative Union of Canada and Le Conseil Canadien de la Cooperation appearing before your committee in Ottawa on May 20th that a request was directed by your committee to have prepared a number of schedules showing the tax position of co-operatives; firstly, at today's date, secondly, as it would be under the White Paper proposals and thirdly, as it would be under the co-operative proposal.

We have now had an opportunity of preparing the information requested and we enclose herewith 50 copies of the same for distribution to your committee. The schedules prepared have been prepared in the English language only which we trust will be satisfactory for this purpose.

Should any questions arise as a result of a review of these schedules we would be pleased to have your questions for further comment.

The taxation committees of the Co-operative Union of Canada and Le Conseil Canadien de la Cooperation will be appearing before the House of Commons Standing Committee on Finance, Trade and Economic Affairs on June 18th. If desirable, repre-

The Honourable Senator S.A. Hayden June 8th, 1970.

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sentatives of these taxation committees could meet with representatives of your committee on the 17th or the 19th to discuss the enclosures.

Yours very truly,

FRANCIS, GAULEY, DIERKER & DAHLEM

Per:

JJD/mm
Encl.

BALANCE SHEET OF MARKETING AND PURCHASING CO-OPERATIVES IN CANADA - 1967

- million dollars -

ASSETS	
Cash	$ 28.1
Receivables	115.1
Inventories	353.9
Other current	10.8
Property, equipment	283.8
Investments	77.4
Other assets	6.5
Total	$ 875.6
LIABILITIES TO THE PUBLIC	
Short-term loans	$ 217.3
Accounts payable	119.5
Other current	11.9
Long-term loans	126.5
Subtotal	$ 475.2
MEMBERS' EQUITY	
Members' loans	$ 42.4
Patronage loans	54.1
Share capital	157.6
Reserves	85.6
Surplus	60.7
Subtotal	$ 400.4
TOTAL	$ 875.6

Source: Co-operation in Canada, 1967 edition, published by Economics Branch, Canada Department of Agriculture, October 1969.

ESTIMATED FEDERAL AND PROVINCIAL INCOME TAXES PAYABLE

MARKETING AND PURCHASING CO-OPERATIVES IN CANADA

1. Under Present Income Tax Act

Corporation Income Tax			
Savings before income tax (Note 1)			$ 47.6
Deduct allowable patronage refund allocation			
Savings		$ 47.6	
3% of capital employed (Note 2)	$ 15.8		
Less interest on long-term loans, member loans and patronage loans (Note 3)	13.4	2.4	45.2
Taxable income			$ 2.4
Income tax at national industry average rate of 33.5% (Note 4)			$ .8
Individual Income Tax			
Patronage refund of $44.4 (Note 5) at national average rate of 11.56% (Note 6)			5.1
Total income tax paid by co-operatives and members			$ 5.9

2. Under White Paper Proposal Without Integration

Corporation Income Tax			
Savings before income tax (Note 1)			$ 47.6
Deduct allowable patronage refund allocation			
Savings		$ 47.6	
8½% of equity of $400.4 (Note 7)	$ 34.0		
Less interest on member loans, patronage loans and share capital - 5% on $254.1 (Note 8)	12.7	21.3	26.3
Taxable income			$ 21.3
Income tax at 50.0%			$ 10.7
Individual Income Tax			
Patronage refund of $34.5 (Note 9) at national average rate of 11.56% (Note 6)			4.0
Total income tax paid by co-operatives and members			$ 14.7

3. Under White Paper Proposal with Integration
(presuming integration possible with patronage refunds)

Corporation Income Tax			
Savings before income tax (Note 1)			$ 47.6
Deduct allowable patronage refund allocation			
Savings		$ 47.6	
8½% of equity of $400.4 (Note 7)	$ 34.0		
Less interest on member loans, patronage loans and share capital - 5% on $254.1 (Note 8)	12.7	21.3	26.3
Taxable income			$ 21.3
Income tax at 50.0%			$ 10.7
Individual Income Tax			
National average rate of 11.56% (Note 6) of $45.2 (Note 10)		$ 5.2	
Less taxable credit (Corporation income tax)		10.7	(5.5)
Total income tax paid by co-operatives and members			$ 5.2

4. Under Co-op Proposal

Corporation Income Tax	
Savings before income tax (Note 1)	$ 47.6
Deduct allowable patronage refund allocation (Note 11)	44.9
Taxable income	$ 2.7
Income tax at individual national average rate of 11.56% (Note 6)	$ .3
Individual Income Tax	
Patronage refund of $44.9 (Note 11) at national average rate of 11.56% (Note 6)	5.2
Total income tax paid by co-operatives and members	$ 5.5

1. Savings for the year 1967 are not reported in the publication "Co-operation in Canada." Therefore, estimated savings before income tax have been calculated on the basis of national average for all Canadian corporations, 11.9% of equity. (Refer to 1967 Corporation Financial Statistics, DBS, table 2, page 47.) 11.9% of members' equity of $400.4 = $47.6

2. The method of calculating capital employed is outlined in the Income Tax Act, section 75, subsection 4(b). In most instances the amount of capital employed is approximately the same as the total of members' equity and long-term loans. For the purposes of this schedule, capital employed has been calculated as the total of members' equity of $400.4 and long-term loans of $126.5.

3. The interest rate used in this calculation is based on a composite average of 6.75% on long-term loans, and 5% on member loans and patronage loans. The 6.75% assumes the long-term funds were borrowed at various rates in prior years.

4. Combined federal and provincial income tax national industry average rate computed from 1967 Corporation Financial Statistics, DBS, table 2, page 47.

5. Under the Present Income Tax Act $44.4 would be available for distribution to members, calculated as follows:

Savings before income tax			$ 47.6
Deduct:	Corporation income tax	$ .8	
	Allocation to reserves - 5% of savings	2.4	3.2
			$ 44.4

6. Combined federal and provincial income tax national average rate computed from 1969 edition of Department of National Revenue taxation statistics not fully adjusted to reflect the Quebec provincial tax.

7. Rate of 8½% is the present approximate interest rate on farm improvement loans referred to in the White Paper.

8. Most provincial statutes limit to 5% the maximum interest or dividends which may be paid on member investment.

9. Under the White Paper proposal without integration $34.5 would be available for distribution to members, calculated as follows:

Savings before income tax			$ 47.6
Deduct:	Corporation income tax	$ 10.7	
	Allocation to reserve - 5% of savings	2.4	13.1
Patronage refund			$ 34.5

10. Individual income calculated as follows:

Patronage refund (Note 9)	$ 34.5
Corporation income tax (taxable credit)	10.7
	$ 45.2

11. Under Co-op Proposal the maximum allowable patronage refund allocation would be the savings before income tax less allocations to reserve and less income tax payable on amounts allocated to reserve:

Savings before income tax			$ 47.6
Less:	Corporation income tax (11.56% on amount allocated to reserve)	$ .3	
	Allocation to reserve - 5% of savings	2.4	2.7
			$ 44.9

APPENDIX 13

DOMINION FOUNDRIES AND STEEL, LIMITED
HAMILTON, ONTARIO

F. H. SHERMAN
PRESIDENT AND CHIEF EXECUTIVE OFFICER

June 2, 1970

The Hon. .Salter A. Hayden
Chairman
Special Senate Committee on
Banking, Trade and Commerce
Ottawa, Ontario

Dear Senator Hayden:

While we were presenting our brief on the steel industry, it was asked whether or not we should have various categories of mines with different treatment.

After considerable thought, we would suggest to you that this is not necessary. As an alternative, we would recommend that the current incentives for mining in Canada be maintained but that the exempt period be limited to the shorter of three years or when the investment has been fully recovered.

This would, in our opinion, take care of any bonanzas which are obviously your major concern, and would at the same time maintain the incentives which have worked well for the mining industry and for Canada as a whole.

Sincerely,

cc:
Mr. Roland M. Breton
Executive Secretary of the
Committee

APPENDIX 14

IMPERIAL OIL LIMITED

111 St. Clair Avenue West, Toronto, Canada

May 14, 1970

Mr. Arthur W. Gilmour
Senior Tax Advisor
The Standing Senate Committee on
Banking, Trade and Commerce
The Senate of Canada
Ottawa, Canada

Dear Mr. Gilmour:

At our hearing before the Standing Senate Committee on Banking, Trade and Commerce on April 8, 1970, we undertook to answer the following question from Senator Everett which appears at page 14:16 of the transcript of the Proceedings: "Could you tell me what portion, in your last fiscal year, that Imperial Oil spent on exploration on its net income before taxes.......from producing operations?"

In 1969 Imperial Oil's exploration costs, including the cost of drilling successful development wells, amounted to 32.5% of our net income from producing operations before income taxes and exploration expenses. If the cost of drilling successful development wells is omitted, the percentage drops to 27.7%.

As we pointed out at our hearing and in our brief, the White Paper $1. for $3. earning limitation on depletion would impose a severe penalty on all those whose eligible expenditures amount to less than 150% of their producing profits, net of income taxes and exploration costs. Since our 1969 eligible expenditures would have equalled 78% of our net producing profits after exploration expenses and income taxes computed on the White Paper basis, the penalty imposed on us would have been severe.

Even under our alternative proposal of a $1. for $2. depletion earning ratio, which has a penalty point of 100% of net producing profits, the penalty imposed on us would be substantial.

Very truly yours,

W.O. Twaits:P
c.c. The Hon. D.D. Everett

APPENDIX 15

INTERNATIONAL UTILITIES CORPORATION

June 10, 1970

Hon. Salter A. Hayden, Chairman
Standing Senate Committee on
Banking, Trade and Commerce
West Memorial Building
Room 1124
Wellington at Lyon
Ottawa, Ontario, Canada

Dear Sir:

At the time of our oral presentation to your Committee on May 28, 1970, you requested us to furnish to the Committee the specific language which IU suggests be added to Sections 4.66 and 4.67 of the White Paper Proposals for Tax Reform concerning the matter of foreign corporations resident in Canada.

As outlined in our Submission IU first proposes that corporations incorporated outside of Canada be permitted to establish or maintain tax residency here unless they are a subsidiary of or are controlled by a foreign corporation domiciled elsewhere, and provided further that a change in the residency status of a foreign corporation resident here be subject to administrative review in order to eliminate tax avoidence. Secondly, IU proposes that if Parliament nevertheless acts to bar foreign corporations in general from tax residency here, an exception (or "grandfather clause") should be written into the new law so that IU and other established public companies are not precluded from maintaining their Canadian residence.

On the first point we suggest the following changes in the language of Section 4.66: The last sentence should read "Under the new proposals, the system of credits for corporate tax would apply only to (1) corporations incorporated in Canada (2) foreign corporations now resident in Canada (except those owned or controlled by foreign corporations not resident in Canada), and (3) foreign corporations which may establish Canadian residency provided (a) they are not owned or controlled by a foreign corporation not resident in Canada and (b) it has been administratively determined that their principal purpose in establishing residency is not one of tax avoidence."

If, however, Parliament should decide against the foregoing proposal and desire a more limited exception, IU proposes that the last sentence of Section 4.66 be changed to read as follows: "Under the new proposals, the system of credit for corporate tax would apply only to (1) corporations incorporated in Canada and (2) foreign corporations which have maintained Canadian residence for at least five years prior to the effective date of the legislation and have had equity securities listed during that period on a Canadian stock exchange."

As pointed out in our brief and oral submission IU has been a Canadian resident since 1961 and has had equity securities listed on the Toronto and Montreal Stock Exchange since 1937. IU would accordingly qualify as a continuing Canadian resident under the foregoing exception.

We trust that the foregoing is sufficient for the purpose of your Committee's deliberations; however, we will be pleased to furnish any additional information that your Committee may require.

Very truly yours,

R. M. BAXTER
Vice President

RMB:clk

APPENDIX 16

KING RESOURCES COMPANY

THE TAXING OF PROFESSIONAL FIRMS AS INCORPORATED BUSINESSES

Study Prepared by Glenn E. Holmes

At the hearings on May 28 last of the Senate Committee on Banking and Finance on the White Paper proposals for tax reform, King Resources Company and its Canadian employees presented a Brief to the Committee. It was pointed out in the discussion that there was a definite tax advantage to being able to incorporate, and that the professionals who could not incorporate their operations because of the personal liability of their calling still required working capital just like any other business. In its Brief, under the heading "Incentives For Small Businesses", the following recommendation was made on Page 30:

> "Certain professions (medicine, law and accountancy) cannot incorporate their operation; but must practice as individuals or partnerships. This, of course, puts these people at a tax disadvantage compared to others who can incorporate. However, viewed in total, these professions form a very small percentage of the independent businesses in Canada. All others can incorporate if they wish and obtain the needed tax relief for small businesses. If any tax changes are to be made in this regard it should be to allow those professions which cannot incorporate to have their operations treated as incorporated businesses for tax purposes."

During a discussion of this paragraph, Mr. Holmes was asked to prepare a paper for the Committee detailing the method by which professional firms could be taxed as incorporated businesses and submit it by June 20 next.

At this point in time it is not known what, if any, White Paper proposals will be adopted. This paper is therefore prepared on the assumption that the present Income Tax Act treatment of corporation taxable income will remain the same.

NEED FOR WORKING CAPITAL

Most professions do not require a large amount of capital to commence operations, unless a going practice is purchased outright. The exception would be certain branches of medicine (such as radiology) and dentistry, where capital is needed initially to purchase expensive equipment necessary for the practice of the profession. Capital is required however to cover the partners' living expenses while the business is building up to the point where cash returns are enough to meet their expenses.

However, as the professional business builds up, a good deal of working capital is required to carry work-in-progress and accounts receivable. This is particularly true of chartered

accountant firms, law firms and dentistry. As most branches of medicine are now covered by some form of medical insurance, doctors usually find that their accounts receivable are collected quicker than the other professions where it is not uncommon for them to be outstanding for a period of three to six months. In addition, lawyers and chartered accountants often find that certain specific assignments for clients will require six months to a year to finalize before they are in a position to actually send a billing to a client. This can mean that from the inception of the particular assignment until payment is received, a time lapse of a year is not uncommon. During this period the lawyer or chartered accountant has to pay his staff's salaries, pay his rent, meet other business expenses and also pay his own living expenses.

In the past, professional people received some relief for the large amount of working capital tied up in work-in-progress and accounts receivable because they were able to calculate their income, for tax purposes, on the cash basis. If the provision of Paragraph 5.46 of the White Paper that the professions will calculate their income on the accrual basis is implemented, the result will be an increase in tax payments by professionals in the early years of their careers, and a consequent decrease in working capital.

Professionals in practice have to pay for the cost of re-educating and updating their education out of their own pockets. In addition to the cost for a one, two or four week course (as the case may be), there is also the loss of chargeable time to the firm. Postgraduate study or re-education in the past has been an expensive item for the medical profession. Today all professions require extensive postgraduate courses. The loss of a partner's billing time in a law or a chartered accountants firm or a medical or dental clinic while he is engaged in re-education will increasingly become a major drain on the working capital of the partnership.

Because of these reasons it is only equitable that professions which cannot incorporate should be allowed to have the income of their firms taxed on the same basis as incorporated businesses and receive the benefits intended in the Income Tax Act for small businesses.

METHOD OF OPERATION

To implement such a scheme under the present income tax act would not appear to be too difficult. It could probably best be handled by adding a section to Division H "Exceptional Cases and Special Rules". This additional section should embody the following points:

1. The right to have a professional firm taxed as a corporation would be by election. Once the election has been made it would be permanent.

2. Any amounts owing by the firm to the individual partners, on which personal income tax had been paid at the date of commencing an election to be taxed as a corporation, could be treated in the same manner as "shareholders' loans" and repaid when the working capital of the firm permitted.

3. Only the firm income received from the practice of the profession should be treated for tax purposes as corporate income. Therefore, any investments would have to be made individually by the partners outside of firm business and income from these investments would, of course, be classed as personal income.

4. The firm could pay salaries to partners. These salaries would be reported on T-4 forms and would be included by the recipients as personal income and treated as a business expense by the partnership.

5. After the firm had paid its corporation income tax any distribution to the partners from after-tax profits would be treated as a dividend, and would be subject to the 20% dividend tax credit.

6. It would be necessary, in the event of a partner leaving or retiring, to apportion any payment to him correctly between undistributed income on hand at the date of his retirement, and any true capital that he had invested in the firm which would not be subject to tax. In this particular case it could be clearly spelled out in the Act that the first distribution would be considered a distribution of undistributed income and would be taxable income subject to the 20% dividend tax credit.

APPENDIX 17

McINTYRE

TORONTO 1, ONTARIO

April 27, 1970

Mr. Roland B. Breton,
Executive Secretary,
Senate Committee on Banking, Trade
and Commerce,
The Senate,
Parliament Buildings,
Ottawa, Canada

Dear Mr. Breton:

During the hearing of our brief, an extract from "The Financial Times of London" was read into the record for which I was asked to supply the date. The article in question appeared on Wednesday, February 4th, on page 19 of that newspaper.

If it is not too late to do so, I should like to draw to the attention of the Committee a quotation from a paper entitled, "Mineral Policy," prepared by the Minderal Industry Research Laboratory of the University of Alaska for the North Commission appointed by the Government of Alaska, which reads as follows:

> "During the past twenty years there has been a spectacular growth of the mining industry in Canada; in this same period metal mining in Alaska has steadily declined. Assuming that geological conditions are somewhat similar, it would seem pertinent to list practices, laws, customs, and economics that are similar or that differ in Canada and Alaska.
>
> "Of all the items listed above, economics is the most important. When economics are discussed, cost is generally stressed; certainly cost is of prime importance. There is however, a less tangible aspect to economics that must be considered; and that is the fact that there seems to be less incentive for the Alaskan population to utilize the natural resources of the country than in, say, northern Canada.

> "This is partially also a social phenomenon and includes the attitudes of the people toward government and of the government's attitude toward the exploitation of natural resources."

The Company wishes to express its appreciation to the Committee for allowing us a hearing at such an early date.

Yours very truly,

A. G. Goodeve
Treasurer

AGG:lf

APPENDIX 18

Ogilvy, Cope, Porteous, Hansard, Marler, Montgomery & Renault
Advocates, Barristers and Solicitors

May 14, 1970.

The Honourable Salter A. Hayden,
Chairman,
Committee on Banking, Trade and
Commerce,
The Senate,
Parliament Buildings,
Ottawa, Ontario.

Dear Sir,

Re: Liberian Iron Ore Limited (Lio)

Enclosed please find a hypothetical statement which indicates the estimated Canadian Income Taxes which would have been paid by the above-mentioned Company during the years 1961 to 1969, inclusive, had the proposals contained in the White Paper been in effect during those years.

The statement was prepared in response to a request when the representatives of the above-mentioned Company appeared before your Committee on April 22, 1970.

Yours truly,

David C. Gavsie

DCG/pk
Encl.

LIBERIAN IRON ORE LIMITED (LIO)

Statement (hypothetical) showing the estimated Canadian Income Taxes which would have been payable to Canada,

(A) assuming

1. a 50% rate of corporate tax for Lio;

2. payment of the balance of profits each year as a dividend (within the year) subject to withholding taxes;

3. a rate of conversion of $1.08 Canadian for $1.00 U.S.; and

(B) on interest - as taken from page 7 of submission of March 12, 1970.

	Corporate Profits (U.S. Dollars)	Corporate Tax at 50%	Withholding Tax (15%) Dividends	Withholding Tax (15%) Interest	Totals (including withholding at 15%	Additional to bring withholding to 25%	Totals (including withholding at 25%
	(Thousands of Dollars - Canadian)						
1961)	Losses			23	23	16	39
1962)	Capitalized			24	24	16	40
1963	Loss of 139 (ignored)			21	21	14	35
1964	308	166	15	17	198	21	219
1965	3,422	1,848	166	14	2,028	120	2,148
1966	3,439	1,856	242	26	2,124	179	2,303
1967	3,371	1,821	251	14	2,086	176	2,262
1968	4,020	2,171	294	14	2,479	205	2,684
1969	5,198	2,807	378	15	3,200	262	3,462
		10,669	1,346	168	12,183	1,009	13,192

APPENDIX 19

Schedule 1

MASSEY FERGUSON.

Comparative U.S. (Iowa) and Canadian (Ontario) Individual Taxes
1970

Schedule 1

TOTAL TAX BURDEN

Salary	Single U.S. Sch. 5A $	Single Canada Sch. 6A $	Single U.S. < Can. (U.S. > Can.) $	%	Married (No Children) U.S. Sch. 5B $	Married (No Children) Canada Sch. 6B $	Married (No Children) U.S. < Can. (U.S. > Can.) $	%	Married (2 Children) U.S. Sch. 5C $	Married (2 Children) Canada Sch. 6C $	Married (2 Children) U.S. < Can. (U.S. > Can.) $	%
10,000	2,334	2,288	(46)	(2)	1,528	1,987	459	30	1,270	1,634	364	29
15,000	4,128	4,123	(5)	-	2,491	3,711	1,220	49	2,198	3,272	1,074	49
20.000	6,346	6,380	34	(1)	3,525	5,916	2,391	68	3,191	5,446	2,255	71
25,000	8,920	8,697	(223)	(3)	4,837	8,235	3,398	70	4,465	7,764	3,299	74
30,000	11,679	11,211	(468)	(4)	6,303	10,696	4,393	70	5,880	10,195	4,315	73
40,000	17,357	16,361	(996)	(6)	9,959	15,846	5,887	59	9,444	15,345	5,901	62
50,000	23,450	21,965	(1,485)	(6)	13,779	21,398	7,619	55	13,183	20,866	7,683	58
60,000	29,819	27,630	(2,189)	(7)	17,513	27,063	9,550	55	16,850	26,531	9,681	57
75,000	39,746	36,839	(2,907)	(7)	24,179	36,221	12,042	50	23,473	35,658	12,185	52
100,000	57,187	52,743	(4,444)	(8)	36,996	52,074	15,078	41	36,219	51,480	15,261	42
125,000	75,201	69,481	(5,720)	(8)	52,506	68,811	16,305	31	51,676	68,217	16,541	32
150,000	93,248	87,445	(5,803)	(6)	68,757	86,724	17,967	26	67,900	85,543	17,643	26

Schedule 2

Schedule 2

Comparative U.S. (Iowa) and Canadian (Ontario) Individual Taxes
(When U.S. 1969 Tax Reform Act and the Canadian White Paper proposals are fully implimented in 1972 and 1975 respectively)

TOTAL TAX BURDEN

Salary	Single				Married (No Children)				Married (2 Children)			
	U.S. Sch. 7A	Canada Sch. 8A	U.S. < Can. (U.S. > Can.)		U.S. Sch. 7B	Canada Sch. 8B	U.S. < Can. (U.S. > Can.)		U.S. Sch. 7C	Canada Sch. 8C	U.S. < Can. (U.S. > Can.)	
	$	$	$	%	$	$	$	%	$	$	$	%
10,000	2,107	2,535	428	20	1,489	2,037	548	37	1,192	1,645	453	38
15,000	3,440	4,421	981	29	2,428	3,873	1,445	60	2,088	3,451	1,363	65
20,000	5,173	6,620	1,447	28	3,433	5,975	2,542	74	3,055	5,506	2,451	80
25,000	7,174	8,924	1,750	24	4,711	8,279	3,568	76	4,282	7,810	3,528	82
30,000	9,391	11,446	2,055	22	6,137	10,729	4,592	75	5,647	10,230	4,583	81
40,000	14,428	16,566	2,138	15	9,696	15,849	6,153	63	9,099	15,350	6,251	69
50,000	19,690	21,686	1,996	10	13,416	20,969	7,553	56	12,725	20,470	7,745	61
60,000	24,953	26,806	1,853	7	17,012	26,089	9,077	53	16,284	25,590	9,306	57
75,000	32,723	34,486	1,763	5	23,383	33,769	10,386	44	22,611	33,270	10,659	47
100,000	45,542	47,286	1,744	4	34,839	46,569	11,730	34	34,063	46,070	12,007	35
125,000	58,379	60,086	1,707	3	47,675	59,369	11,694	25	46,900	58,870	11,970	26
150,000	71,216	72,886	1,670	2	60,512	72,169	11,657	19	59,737	71,670	11,933	20

APPENDIX 20

CANADIAN CONSTRUCTION ASSOCIATION

CONSTRUCTION HOUSE, 151 O'CONNOR ST.,
OTTAWA 4, CANADA
AREA CODE 613/236-9455

OUR FILE 214

April 30, 1970.

Hon. J.J. Connolly,
Room 271-S,
The Senate,
Parliament Buildings,
Ottawa 4, Ont.

Dear Senator Connolly:

During this morning's hearing you made particular reference to northern development construction and the high risk nature of construction operations generally. I commented that a good deal of northern construction work was being carried out and that it was associated with above-average risks on the part of both the contractor and the investor. Further, that many of the recommendations contained in our Brief related directly to the desirability of recognizing the uncertainties and variables in construction operations, such as are summarized on pages 8 and 9 in our submission.

One of the recommendations contained in the Brief has specific reference to construction work up north and in other remote areas. This advocates that higher capital cost allowances be provided for construction equipment that is used on such projects and is abandoned on the completion of the work because it is too expensive to bring it back. (page 32, penultimate paragraph). Also, reference is made to the need for higher capital cost allowances for generating sets used by contractors as a main source of power on remote sites. (page 33, second paragraph).

Finally, Appendices E and F show the profit and loss statistics and bankruptcy figures for the construction industry. It will be noted that, on average, over one third of the construction companies report a loss on their year's work and that there were approximately 450 bankruptcies reported last year in the construction industry. The latter number was exceeded only by the number in Trade.

Yours sincerely,

SDCC*MW

General Manager.

APPENDIX 21

THE TORONTO STOCK EXCHANGE

AUGUST 7TH, 1970.

THE HONOURABLE SALTER A. HAYDEN,
CHAIRMAN,
THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE,
THE PARLIAMENT BUILDINGS,
OTTAWA, ONTARIO.

DEAR SENATOR HAYDEN:

IN OUR LETTER OF JUNE 30TH TO YOU, WE ENCLOSED A COPY OF THE NEW YORK STOCK EXCHANGE STUDY ON CAPITAL GAINS TAXES, AND SAID THAT WE WOULD ATTEMPT TO SECURE SOME MATERIALS ON A PARALLEL STUDY DONE BY THE U. S. TREASURY DEPARTMENT.

I AM PLEASED TO INFORM YOU THAT WE CAN NOW PROVIDE YOU WITH SOME MORE EXACT DETAILS OF THE U. S. TREASURY STUDY.

ON PAGES 199 AND 200 OF A BOOK ENTITLED "ALTERNATIVE APPROACHES TO CAPITAL GAINS TAXATION" BY MARTIN DAVID, REFERENCES ARE MADE TO THE U. S. TREASURY STUDY. IN EFFECT, THE STUDY CONCLUDES THAT WITH A LESSER CAPITAL GAINS TAX RATE, THERE WOULD BE A SUBSTANTIALLY GREATER REVENUE ACCRUING TO GOVERNMENT BECAUSE THE TURNOVER RATE OF ASSETS WOULD BE ACCELERATED.

I AM ENCLOSING COPIES OF THE PAGES 199 AND 200 MENTIONED ABOVE.

FOR GREATER DETAIL YOU WOULD HAVE TO SECURE A COPY OF "PRESIDENTS' 1963 TAX MESSAGE, HEARINGS BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS, 88 CONGRESS 1ST SESSION (1963) PT.1, PP. 63 AND 708.

I TRUST THIS IS HELPFUL.

YOURS TRULY,

H. W. F. MCKAY.

HWFM/GW
ENCL.

gains from the tax base was increased, the income tax would approach a schedular tax levied largely on recurrent contractual payments of rent, interest, and salaries. Other forms of income could be converted into capital gains. The incentives to convert profits, dividend payments, and other returns to entrepreneurial activity into the form of capital gains would become progressively greater as the margin between capital gains and ordinary income taxation was widened. Taxpayers could and would take advantage of the difficulty of defining eligible transactions to convert their receipts into capital gains.

Countries that have applied a schedular tax to income that excludes capital gains have discovered that a large proportion of the income of high-income persons escapes taxation.[2]

The taxpayer compliance costs, legal fees, and management effort that would be required in ferreting out the opportunities for tax avoidance would be augmented by a greater exclusion of capital gains from income. Greater stress would be placed on the weak links in the present capital assets definition and the arbitrary devices used to separate ordinary income from capital gains. The administrative effort devoted to litigation and auditing capital gains deductions would have to be increased. Tax yields would be reduced by a continuing erosion of income presently taxed at ordinary rates.

The effects on the capital market of a greater exclusion of capital gains would be mixed. Increased trading and increased savings would be associated with a lower level of disincentives and more preferential treatment of income saved through appreciation. However, the increased rates of retention of corporate earnings stimulated by the preferential capital gains tax might increase capital rationing and reduce the availability of funds to fledgling enterprises. (See pages 150-55 and 174-80.)

The New York Stock Exchange and the Treasury Department both have estimated that enough trading of assets would be induced under a system of reduced inclusion to increase Treasury revenues permanently. Reduced inclusion thus could finance a limited reduc-

1 sess. (1955), pp. 367-81. Reduced inclusion *and* a reduced maximum alternative rate were recommended in the New York Stock Exchange's interview study reported in *A New Look at the Capital Gains Tax Rate* (New York Stock Exchange, October 1965).

[2] Richard M. Titmuss, *Income Distribution and Social Change; A Study in Criticism* (London: George Allen & Unwin, 1962).

tion in current tax rates. Any economic effects of this change in tax structure would be secondary in character. The Treasury has estimated that with the capital gains deduction increased to 70 percent, there would be a net revenue increase of approximately $600 million when the proposal was fully effective.[3] The New York Stock Exchange estimated that a $120 million increase in revenues would be associated with the sale of stocks if the deduction were increased to 60 percent and that the alternative tax would provide for a maximum rate of tax on capital gains of 20 percent. An increase in revenues of $320 million would result from sales of stock if the deduction were increased to 75 percent of capital gains and the alternative maximum rate were reduced to 12.5 percent. Since the gains on corporate stock comprised slightly less than half of all gains realized in 1959, one would expect an aggregate increase in revenues of perhaps twice as much. However, it is likely that the turnover of assets of other type would be less influenced by tax considerations. Real estate and business assets are less liquid and more likely to be held for current income.

A reduced percentage inclusion would have some positive economic effects—at an unpredictable cost of increased distortion of investment activity toward areas particularly favored by capital gains treatment, and of decreased equity in the tax structure.

Roll-over of Capital Gains

Several proposals to mitigate the lock-in effect of capital gains taxation call for the postponement of tax liability so long as the proceeds of an asset transaction are appropriately reinvested. This proposed modification of the income tax has been termed a "roll-over of capital gains."

Since roll-over is basically a principle for determining the timing of tax payments on capital gains, it could be incorporated into any one of many systems for taxing capital gains. Gains may be taxed at

[3] *President's 1963 Tax Message*, Hearings before the House Committee on Ways and Means, 88 Cong. 1 sess. (1963), Pt. 1, pp. 63 and 708. The immediate revenue loss would be $110 million on the present tax base for individuals; however, the increased turnover of assets would produce a $450 million increase; and induced changes associated with the increased level of economic activity stimulated by the tax cut proposed in 1963 would produce a $260 million increase.

TORONTO STOCK EXCHANGE

AN ESTIMATE OF THE COST OF THE GRADUATED DIVIDEND RECEIVED CREDIT AS PROPOSED IN THE T.S.E. SUBMISSION RE THE PROPOSALS FOR TAX REFORM

The Toronto Stock Exchange submission The White Paper and the Canadian Capital Market recommends (for reasons summarized on page 22 of the submission) that the White Paper proposals regarding the integration of corporate and personal income taxes not be implemented. It recommends instead that a graduated rate of dividend tax credit be substituted for the present 20% flat rate. The submission suggests (page 22) that:

> "It would be possible by selecting appropriate rates of credit to confer the same degree of relief from double taxation to all shareholders, regardless of their marginal tax rates. Such a graduated system would satisfy the equity requirements advanced in the White Paper, while avoiding the discrimination, bias, and other distortions generated by the White Paper proposals."

A graduated dividend received credit ranging "from, say, 25% for low-income investors, to possibly 15% for high-income investors" was recommended. It was estimated that this graduated credit scheme would cost the Treasury about the same as the present credit provision and would thus be less costly than the White Paper integration proposals. The White Paper estimates (para. 8.22) that the additional costs of the integration proposals given in that Paper would be in the range of $140 million to $230 million.

The T.S.E. submission further recommends that the saving resulting from its suggested graduated dividend credit be used to

permit implementation of a more modest capital gains tax. The submission then adds:

> "It is our considered opinion that the combination of a more modest relief from double taxation, together with a lower rate of capital gains tax, would cause the capital market to respond in such a manner as to promote a more satisfactory rate of development of our unexploited economic opportunities than would prevail were the White Paper proposals implemented."

To the extent that available data permit, the attached calculations demonstrate the comparability in cost to the Treasury of the suggested 15-25% graduated credit and the existing 20% credit. Using the latest published taxation statistics (1967) and structuring the graduated scale such as to grant approximately equal proportionate relief to all investors, these calculations indicate a cost to the Treasury in the order of $107 to $110 million, depending on whether a "Taxable Returns" or "All Returns" basis is used. The actual cost of the existing 20% credit was almost $106 million.

(All figures refer to 1967 and are expressed in $000's)

TAXABLE INCOME CLASSES (2)

	(a) No Tax (3)	(b) $1-5,000	(c) $5,000-$10,000	(d) $10,000-$15,000	(e) $15,000-$20,000	(f) Over $20,000	(g) Total
1. GROSS DIVIDENDS							
(i) Taxable Returns	172	137,187	128,542	60,775	43,562	219,239	589,477
(ii) All Returns	4,489	143,480	128,974	60,909	43,598	219,317	600,767
2. DIVIDEND TAX CREDIT (4) (at present flat rate of 20%)							
(i) Taxable returns	16	21,512	23,893	11,477	8,169	40,728	105,795
(ii) All Returns (actual 1967 figures)	22	21,526	23,895	11,478	8,169	40,728	105,818
3. PROPOSED SCALE (1)	25%	22%	20%	18%	17%	15%	
4. DIVIDEND TAX CREDIT (5)							
(i) Taxable Returns	43	30,181	25,708	10,940	7,406	32,886	107,164
(ii) All Returns (as the scheme would have operated in 1967, under the proposed sliding scale)	1,122	31,566	25,795	10,963	7,412	32,896	109,754

Source: Taxation Statistics, 1969 edition
Department of National Revenue, Taxation.
Table #2: All Returns by Income Classes.

METHODOLOGY

NOTE 1: In order to assure that all investors should have approximately the same proportionate degree of relief, the rate of dividend tax credit allocated to each class of income has been calculated according to the formula:

$$* \; r = \frac{c(1-t)}{t(1-p)}$$

* See page 28, 'The Income Tax Burden on Canadian Stockholders', J.R. Allan. 1966 Canadian Tax Foundation for derivation of this formula.

where r = ratio of the dollar amount of credit claimed to the dollar amount of differential taxation. Differential tax shows how the corporate and personal income tax burdens on a stockholder's share of corporate earnings compare with the burden that the stockholder would incur in respect of an equal amount of income from a non-corporate source.

c = rate of dividend received credit

t = rate of corporation tax

p = marginal tax rate of the investor.

Setting $c = 0.15$, $t = 0.50$, and $p = 0.512$ (this assumes that a 15% dividend received credit is granted to investors in the highest tax bracket proposed in the White Paper), the proportionate degree of relief (r) is equal to 30.74%.

Using the same formula, and holding the degree of proportionate relief constant at 30.74%, the appropriate dividend tax credit rates were calculated (to the nearest whole number) for the range of marginal tax rates corresponding to the income classes shown below.

Taxable Income Class	Approximate Marginal Tax Rate for Class*	Proposed Dividend Tax Credit	Actual Degree** of Proportional Relief
$ 0 - 1,000	22.4%	25%	32.21%
1 - 5,000	27.7	22	30.43
5 - 10,000	34.8	20	30.67
10 - 15,000	39.9	18	29.95
15 - 20,000	45.3	17	31.08
20,000 +	51.2	15	30.74

* In general, this represents an average of the marginal tax rates of the various income groups composing the income class.

** The actual degree of proportional relief varies slightly between income classes because proposed dividend tax credit rates are rounded to the nearest whole number.

NOTE 2: Taxable income classes are derived from the "income classes" shown in Table 2 of the 1969 Edition of Taxation Statistics. The conversion from "income class" to taxable income class was achieved for each class by subtracting the average 'exemptions and deductions' (from items 1 and 36 in Table 2) from the average income class figure. The resulting taxable income figures were then grouped as shown above. The Table below shows the relationship between taxable income classes and income classes.

Taxable Income Class	Income Class
1. No Tax	Under $1,100
2. $ 1 - 5,000	$ 1,100 - 8,000
3. $ 5 - 10,000	$ 8,000 - 15,000
4. $10 - 15,000	$15,000 - 20,000
5. $15 - 20,000	$20,000 - 25,000
6. $20,000 +	$25,000 +

NOTE 3: There would normally be no taxable returns where income is less than $1,100. However, certain returns in this class are taxable, for reasons such as the following:

a) persons resident in Canada for only part of a tax year are granted exemptions calculated on the same basis.

b) Non-residents of Canada do not receive personal exemptions but may derive small incomes from Canada.

c) Certain returns are taxable only in respect of lump sum pension payments which are excluded from total income.

NOTE 4: The 'dividend tax credit' figure should, in theory, be equal to 20% of the gross dividend figure. In fact, it is less than this for every income group. One explanation for this may be that some shareholders may not be aware of the right to claim the credit. Another explanation may be that certain lower income shareholders may not have sufficient tax liabilities against which the dividend tax credit can be offset.

NOTE 5: The method of calculating the dividend credit received under the proposed graduated scale implies that all taxpayers can, and do, claim the full amount of tax credit to which they are entitled. If no rebate is granted where the credit exceeds the tax liability and/or to the extent that some taxpayers do not claim the credit to which they are entitled, the cost to the Treasury will be less.

CONCLUSION

Column (g) of the Table shows that the cost of the graduated scale in 1967 would have been closely comparable to the actual cost of the flat rate 20% scheme, ($107.2 million against $105.8 million for taxable returns).*

In order to show the maximum potential cost of the proposed graduated scale of divident credit, the cost has been calculated for all returns as well as for taxable returns. Once again the cost of the graduated scheme, at $109.8 million, is very similar to the actual cost of the 20% flat rate of $105.8 million.

Moreover, as already noted in Note 5 above, the calculation of the costs of the graduated scheme assumes that all taxpayers will claim the full amount of their dividend credits and that tax refunds will be made to those shareholders who do not have sufficient tax liabilities to make use of the dividend credit. A tax refund of this kind is not an essential part of the T.S.E. proposal and need not be incorporated in a graduated dividend credit scheme if it was thought undesirable for administrative or other reasons. If tax refunds are not granted and if, as seems likely, some taxpayers fail to claim their dividend credits, then the cost of the graduated scheme to the Treasury will be less than calculated above.

* The cost in 1969 of the graduated dividend tax credit outlined above can be estimated by allowing for the growth in dividend income since 1967. The DBS National Accounts average annual rate of increase for "interest, dividends, and net rental income of persons" for the period 1963-1967 was 7.3%. Applying this growth rate to the total dividend tax credit for all returns indicates that the cost would have been $126,363,000 in 1969. Using the same growth rate for the next five years gives a cost in 1974 of $179,730,000. It should be noted that this estimate makes no allowance for any increase in dividends brought about by the tax system proposed in the White Paper.

APPENDIX 22

TEXACO CANADA LIMITED

1425 MOUNTAIN STREET

MONTREAL 107, QUE.

July 7, 1970

The Honourable Salter A. Hayden
Chairman,
The Standing Senate Committee on
Banking, Trade and Commerce,
The Senate,
Ottawa, Canada.

Dear Senator Hayden:

During the appearance of Texaco Canada's representatives before your Committee on June 10th Senator Everett requested that we provide supplementary information regarding the company's effective tax rates. We were also asked to suggest means of financing government programs if tax rates competitive with those prevailing in the U.S. were adopted by Canada. We were further requested to comment on the possible use of a value-added tax as a means of providing additional government revenue.

The above are dealt with in turn hereunder.

EFFECTIVE TAX RATES

There are various methods of computing such a rate. We have included two. We believe the most appropriate is based on taxable income as illustrated on Statement I because it permits a more realistic comparison with other taxpayers in the industry as well as with taxpayers engaged in other industries.

You will note that Statement I adds to the income base, depletion allowances claimed, as well as capital taxes levied by the provinces of Ontario and Quebec under their Corporation Tax Acts, which taxes have been charged

to expense in computing income subject to income taxes. The Quebec capital tax includes a special annual levy against refining and telephone companies operating in Quebec, being one-third of 1% of paid-up capital, as defined. In addition, the capital tax on petroleum marketing and refining companies in Quebec is substantially higher than the rate applicable to ordinary companies.

Statement I indicates an effective tax rate for Texaco Canada of 49.2% in 1969 and 50.3% in 1968.

As indicated during our appearance before your Committee June 10th and as well as in our formal submission, the oil producing industry contributes very heavily to public revenues in a manner unequalled by any other industry. No realistic assessment of the impact of the industry on government revenues is possible without taking such items into consideration. For example, during the past 10 years Texaco Canada paid to governments $33.3 million for mineral rentals, royalties and bonuses whereas income taxes applicable to producing operations for the same period totalled $14.3 million. Since 1947 the industry as a whole has contributed about $3.6 billion to governments by way of mineral payments, an amount far in excess of income taxes paid because only a relatively few companies have earned sufficient income to require the payment of such taxes. These few statistics illustrate that the petroleum industry has made and is continuing to make a significant contribution to government revenue even though many companies in the industry have not yet earned sufficient income to be in a taxable position.

Most of the mineral payments to date have been made to the provinces, primarily the province of Alberta. However this has resulted in direct benefits to the federal government in eliminating Alberta, and to a lesser extent B.C., Saskatchewan, and Manitoba from federal equalization grants. Further, the potential direct benefits to the federal government are great considering that more than 80% of the oil rights now held under lease are federal lands. With adequate incentives to spur exploration coupled with future successes, the federal government's share of direct revenues could be substantially increased.

Statement II indicates effective rates of taxes based on book income as published in the company's 1969 report. The rates computed in this manner were 45.3% for 1969 and 45.8% for 1968. We suggest that this method of computing effective rates of tax is misleading because wide variations occur from year to year for the same companies and between corporations in different industries, depending upon the amount of capital cost allowance, exploration costs, accounting principles followed etc. The rate would be affected by depletion claimed and to this extent Texaco Canada's rate should be lower than that of non-resource industry corporations, but it is also affected substantially by costs claimed for tax purposes in a period different from the accounting period in which they are charged against income.

BALANCING THE BUDGET

As indicated in our formal submission, we strongly believe that Canada's tax rates must in the long run be competitive with those prevailing in the U.S. to permit us to compete effectively for capital and manpower with the ultimate objective of providing a standard of living to Canadians comparable to that enjoyed by U.S. residents. We recognize that differences in social benefits and conditions may permit a discrepancy in personal tax rates for certain groups of people but care must be exercised to ensure that the country's most productive people are encouraged to employ their talents in Canada. Higher tax rates in Canada which are applied to middle and upper income groups to provide increased social welfare to the poor would likely keep the poor in Canada but encourage the more skilled and highly mobile middle income groups, who are asked to carry the burden, to accept more attractive opportunities elsewhere.

A reasonable balance must be struck between the services Canadians want to provide, as interpreted by the government, and what the economy can afford. In this respect we should not expect to keep too far ahead of our major international competitors without having adverse economic effects on Canada.

Some Canadians including officials of the Department of Finance, believe that all residents of this country must accept as inevitable the necessity of carrying a heavier tax burden than the Americans because the desired levels of benefits in Canada are higher while productivity and incomes are lower. We believe such a conclusion would be disastrous economically if accepted by governments and most discouraging to Canadians having aspirations of closing the standard of living gap existing between themselves and their American friends.

Canada is blessed with abundant natural resources, a reasonably well-educated work force and established trade patterns which, if carefully exploited to the maximum, should provide the base for a standard of living equal to or better than that of any country in the world. Governments should try to establish an economic climate conducive to achieving this end. Two essential features of a satisfactory climate are; firstly, competitive levels of taxation and secondly, the establishment of policies which would encourage the flow of capital and human resources to industries that can compete in world markets on an equal footing.

Natural resource development industries are prime examples of industries capable of creating wealth for the benefit of Canada provided they are not handicapped by taxation and other burdens which exceed those carried by their international competitors.

Natural resource-development industries stimulate the development of related processing and manufacturing industries as well as secondary manufacturing operations of existing industries. Mineral development also stimulates the growth of related service industries and a high degree of new technology, providing increased employment opportunities for Canadians.

The history of the development of the province of Alberta during the past few decades demonstrates the contribution of the oil industry to the progress of that province. At the time of the Leduc discovery in 1947 Alberta was in a period of very slow population growth

because the primarily agriculturally-based economy required fewer workers due to increased mechanization. Immediately following the Leduc discovery the population grew at a rapid rate. The increase in the five year period 1951-56 was 20%, almost entirely due to oil development.

The primary oil development attracted related development including transportation and processing facilities. Secondary industries such as chemicals, oil refining, steel and manufacturing of a broad range of goods sprang up. One authority has estimated that Western Canada's population is now between a million and a million and a half greater due to oil development than would otherwise have been the case. This was accomplished at no cost to the federal treasury. The consequent development has produced wealth that has been shared by all Canadians.

To repeat, government policy should be aimed at encouraging further development of the kind outlined above. The result would have the double barrelled effect of providing, fuller employment which would reduce the need for additional welfare schemes, and a broader tax base to produce revenue for essential government services. The adoption of the White Paper proposals would have the opposite effect, i.e. it would discourage development in the long-term resulting in reduced employment and a narrower tax base.

The gap between Canadian and U.S. tax rates could not be closed immediately without incurring deficits but we believe a determined effort should be made to eliminate the differences in as short a period as possible. This will be possible only if expenditures are curtailed and policies are adopted to expand production to increase tax revenue.

VALUE-ADDED TAX

The Canadian economy cannot afford any new taxes which add to the total tax burden because the total tax load in relation to total output of the country is already excessive as compared with our international neighbours. A value-added tax should therefore be examined from the point of view of a substitute for other forms of taxation.

During recent years there has been a movement towards adopting value-added taxes, particularly among European countries. In some cases it is used as a means of reducing corporation taxes on the theory that this system gives manufacturers a competitive edge in foreign markets. The theory is based on the argument that corporation taxes are built into the cost of manufactured goods thereby increasing their cost and consequently limiting their markets whereas value-added taxes are paid entirely by domestic consumers on locally manufactured goods as well as imported products.

The above theory has been challenged by a number of observers on the grounds that the value-added tax increases the cost of living and consequent wage demands of workers, thereby increasing the cost of production in the long run. Experience in European countries has proven that the tax tends to be inflationary, particularly if implemented during prosperous economic periods. The Netherlands, Denmark and France all experienced immediate inflationary price increases upon the imposition of the tax. For fear of further upward price pressures Belgium and Italy have delayed the planned imposition of the tax until 1971 and 1972 respectively.

Canada already has a system of taxing commodities, which many critics suggest is a form of VAT. The federal 12% sales tax on manufactured goods is the largest single element in the commodity tax system in Canada. The tax is a single stage tax applied at the manufacturer's level with exemptions for such items as food, fuels, drugs, production machinery and goods used in the manufacture of taxable goods. The tax is levied on imported goods but is excluded from exports.

Excise taxes and duties, in addition to the general sales tax, are applied to specific commodities at varying rates. Examples are tobacco products, alcoholic beverages, television sets, toilet articles, jewellery, etc.

Provincial governments levy commodity taxes in the form of retail sales taxes and taxes on specific goods such as gasoline, liquor and tobacco.

The total taxes and duties on commodities levied by the federal and provincial governments produced in excess of 40% of tax revenue received by such governments in 1967. A value-added tax would presumably require a revision of the present commodity tax system to prevent such taxes from becoming an unreasonably high proportion of the total cost of goods. Such a revision would require joint action by federal and provincial governments because this field is presently shared by both levels of government. The variations in tax rates from province to province would add further difficulties to effecting changes.

Sales taxes, including value-added taxes, are generally considered to be regressive because they relate to consumption rather than income. Their regressivity may be reduced by establishing a system of exemptions for basic necessities but such exemptions seriously erode the base and reduce the revenue potential unless very high rates are levied on goods which are taxed.

In conclusion, we do not recommend the adoption of a new value-added tax for Canada. The present system of commodity taxation is sufficiently similar to a VAT to obtain most of its benefits as a revenue producing tax and has the added advantage of being tailored to suit the country's peculiar constitutional requirements.

We wish to thank your Committee for the opportunity of discussing our submission on June 10th. We hope it will be helpful in the preparation of your report. If there is any point on which you would like further elaboration or an expression of opinion, we would be happy to comply.

Yours very truly,

/lw
Encl.

STATEMENT I

TEXACO CANADA LIMITED

COMPUTATION OF EFFECTIVE TAX RATE ON TAXABLE INCOME BEFORE DEDUCTING DEPLETION ALLOWANCES

	(Millions of Dollars)	
TOTAL COMPANY	1969	1968
Taxable income as filed	$27.1	$29.0
Add: Depletion Allowance	3.5	3.4
Provincial Capital Taxes	.3	.2
Adjusted Income Base	$30.9	$32.6
Taxes Paid:		
Federal and Provincial Income Taxes	$14.9	$16.2
Provincial Capital Taxes	.3	.2
	$15.2	$16.4
Effective Tax Rate	49.2%	50.3%
PRODUCING DEPARTMENT		
Other major payments to governments which are unique to the petroleum industry -		
Royalties	$ 3.4	$ 2.4
Lease Rentals	.1	.1
Lease Bonuses	.8	.4
	$ 4.3	$ 2.9
Income Taxes Applicable to production and exploration operations	$ 4.1	$ 4.1
Other payments (above) expressed as a percentage of income taxes applicable to producing and exploration operations	105%	72%

STATEMENT II

TEXACO CANADA LIMITED

EFFECTIVE TAX RATE COMPUTED ON BOOK INCOME
YEARS 1968 AND 1969

	(Millions of Dollars)	
	1969	1968
Book income (before extraordinary item)	$21.3	$20.8
Add:		
Income Taxes - Current	14.9	16.2
- Deferred	2.5	1.2
Provincial Capital Taxes	.3	.2
Base	$39.0	$38.4
Income and Capital Taxes (Above)	$17.7	$17.6
Effective Tax Rate	45.3%	45.8%

APPENDIX 23

SUPPLEMENTARY SUBMISSION BY SYNCRUDE CANADA LTD.
WITH RESPECT TO PROPOSALS FOR TAX REFORM

This submission is supplemental to the submission already filed under date March 1970. It derives from questions asked by Members of the Standing Senate Committee on Banking, Trade and Commerce in the course of the appearance before that Committee of the company's representatives on April 29th, 1970.

1. Syncrude's original submission proposed that exemption from abolition of the three year mining exemption and percentage depletion allowance now contained in the Income Tax Act be granted for the Athabasca tar sands as opposed to any particular project being carried on by any particular taxpayer or taxpayers therein. As an alternative to basing the exemption on a geographic definition (and in fact there are two or three other tar sands deposits in Canada that are not part of what is commonly described as the Athabasca tar sands) Syncrude's representatives were asked if a definition could be put forward so that the exemption from the White Paper proposals could be set forth in terms of a description of the extraction process itself.

As that alternative, Syncrude would submit that exemption be granted from the White Paper proposals to abolish the three year mining exemption and percentage depletion allowance for "income derived from mining bituminous sand".

That phrase parallels the wording of present provisions of the Income Tax Act contained in section 83(5) and 83(6)(a), and should accordingly fit easily into the general context and construction of that Statute.

2. Syncrude's representatives also undertook to submit some supplementary ideas on the question of mechanics, i.e., how the income from the process thus described, or from processing Athabasca tar sands if the exemption is expressed in geographic terms, would be identified so as to qualify for such exemption. On considering this point, it appears that income from a particular source (however that source is described, whether as an area or as a process) would be most effectively exempted from the White Paper proposals by simply providing that income derived from the prescribed source would qualify for the exemption, or to put the matter positively, would qualify for three year exemption and percentage depletion allowance. That is essentially the approach taken in section 83(5) of the present Income Tax Act, which speaks of "income derived from the operation of a mine". The present percentage depletion allowance is provided for in sections 1200 and 1201 of the Regulations made pursuant to the Income Tax Act and it is provided in section 1201(2) and 1201(5)(f) that the deduction is 33-1/3% of a taxpayer's production profits, which are those profits reasonably attributable to the production of oil, gas, minerals, etc.

Such a provision would leave the onus where it now rests upon the taxpayer to allocate or identify his income as coming from a particular source, a matter that has not given rise to any particular difficulty in the present taxing structure.

3. Syncrude's representatives were also asked to comment on a proposal attributed to Shell Oil Company of Canada to substitute a fast write-off with a carryforward provision coupled with a gross depletion allowance of, say, 20% for the three year tax-free period and present percentage depletion allowance based on net income. On consideration, we find that Syncrude, although agreeing in principle

with a gross depletion formula, cannot take a single position with respect to that proposal, and accordingly would prefer not to enter into any discussion of its merits. Two of the Syncrude participants, namely, Gulf and Imperial, have made submissions to this Committee representing their respective views on the Shell proposal.

It remains our submission that regardless of what might be found suitable for the conventional petroleum and mining industries, the Athabasca development should have a chance to proceed according to the ground rules under which it has been planned.

APPENDIX 24

SHELL CANADA LIMITED

CORPORATION/SHAREHOLDER TAXATION

RECENT U.K. AND U.S. AMENDMENTS

RE CANADIAN WHITE PAPER PROPOSALS - NOVEMBER, 1969

Generally, the present systems in this area of taxation seem to have been dictated by procedural and economic considerations, not only in the case of the U.K. and U.S. but also of such highly developed countries as France and Germany. Nowhere have we encountered the avowed objective of a government to eliminate double taxation on the grounds of fundamental equity.

Indeed, the Chancellor of the British Exchequer, in introducing the separate corporation tax in 1965, pointed out that the double taxation theory was a product of the last century when the few incorporated companies could be looked upon as large partnerships. In his opinion, modern business and taxation methods had made this concept obsolete, and it was logical today to impose separate taxes on corporations and individuals.

Before dealing with the U.K. and U.S. system in detail, we would like to make brief reference to the German and French systems of corporation/shareholder taxation and make a few observations on the principles involved.

Germany elected in the 1950's to reduce the level of taxation on distributed corporate profits. It did so in the main to create wider interest in public equity investment, apparently feeling that this was a sounder basis for economic growth than the then inordinate reliance on corporate earnings retained by businesses. Having thus decided to promote dividend distributions, it chose to do this through the corporation tax structure rather than at the shareholder level (15% tax on distributed profits as compared with 51% on undistributed profits). This approach had two side-effects: firstly, it enabled the government to make the distribution objective particularly effective, i.e. by making the 15% rate conditional upon immediate distribution of current profits; secondly, the tax reduction automatically became available to foreigners as well as residents, since shareholder tax credits were not involved in the system.

In 1965, France adopted a 50% integration scheme basically similar to that proposed by the White Paper for widely-held Canadian corporations. It was motivated in this mainly by the fear that French capital was migrating to neighbouring countries which imposed lower overall taxes on distributed

corporate earnings. It is significant, however, that France elected to reduce taxation at the shareholder level rather than the corporate level, and to deny the shareholder tax credit to non-residents ("France for Frenchmen"). Now we understand that the latter objective is collapsing, since other nations are demanding the dividend tax credits for their residents in treaty negotiations with France.

It is not Shell Canada's purpose to argue the merits of full and complete "double taxation" of corporate profits. Indeed, this could not be done in Canada without disastrous economic impact, in view of the existing tax reduction represented by the 20% dividend tax credit and the proposed capital gains taxation. In recommending separate corporation and dividend taxes, we wished to establish the unfavourable economic, equity and administrative cost consequences of the White Paper/Carter approach, which implies the "creditable tax" system.

In our opinion, the Canadian government is wrong in disregarding the flexibility and basic simplicity of the separate tax system in favour of an intellectual concept and, as we see it, a futile search for fundamental equity. For example, perhaps corporation taxes should be reduced while dividends are fully taxed as ordinary income toshareholders. Or perhaps the corporation tax rate should be reduced only for distributed profits, with dividends taxed to shareholders as ordinary income, as Germany has done. We believe the White Paper proposals should have been based on such realistic analyses of economic objectives.

United Kingdom

Until 1965, distributed corporate profits were subjected only once to the standard income tax. The corporation was assumed to have already paid the tax and there was no further tax in the hands of shareholders (except surtax, where applicable). A feature of the system was that, where the shareholder was exempt or partially exempt from income tax, he could claim a tax refund from the Revenue in respect of his dividends even though the corporation may never have actually paid the tax, e.g. because of non-taxable gains, capital cost and investment allowances etc.

In introducing the separate flat-rate, non-creditable corporation tax (then 40%) in 1965, the Chancellor of the Exchequer stated, in addition to the remarks on double taxation to which we have already referred, four reasons for the change:

1. There was insufficient incentive for companies to retain earnings for growth.

2. The taxation of corporations was unduly complicated (in addition to the creditable income tax, corporations were subject to a "profits" tax calculated on a different base).

3. The system could not easily be adapted to serve the economic aims of government.

4. There were many anomalies and abuses, mainly taking the form of recovery of tax from Revenue which had never been paid in the first instance.

Our London colleagues tell us that No. 4 was probably the main reason for the change, and there were apparently many taxpayers who thought that such abuses, along with the complications referred to in No. 2, could have been corrected without complete abandonment of the integrated system.

However, we are informed that criticism has largely died away and that, now that taxpayers are used to the new rules, the 1965 system is not basically unpopular. Our U.K. people do point out that there is continuing dissatisfaction with the absolute level of taxation of corporate earnings (corporation tax at 45%, plus the individual's standard rate of income tax on dividends at 41.25%, for a total effective tax rate of some 68% on distributed profits).

They also make a point which has a bearing on the general remarks we made earlier on the question of balancing relief at the corporate level and at the shareholder level:

> "The fixing of the corporation tax at a relatively low rate (for developed countries), with dividends taxed at the high U.K. personal rates, means that overseas investment is penalised, as tax paid overseas is frequently in excess of the U.K. corporation tax, but no relief for the excess can be claimed against the income tax on dividends paid. The overall tax burden thus becomes even higher than the 68% mentioned above. For a country which benefits very considerably, in the long-run, from overseas investment this is not considered to be desirable."

United States

For many years the U.S. has taxed corporations and individuals separately. However, until 1964 relief from "double taxation" was granted at the shareholder level by providing an annual $50 exclusion of domestic dividends from personal income, plus a 4% tax credit on dividends in excess of that amount. In 1964, the exclusion was raised to $100 and the tax credit reduced to 2%; for 1965 and subsequent years, the tax credit was removed entirely. At the same time, the corporation tax rate was reduced from 52% to 50% in 1964 and 48% in 1965 and subsequent years.

Our U.S. associates have sent us a copy of the report of the Senate Finance Committee on Bill H.R. 8363, which contained the foregoing amendments. The following excerpts are of particular interest:

1. "In fact, reduction in the corporate rate by 4 percentage points probably does as much to remove any double taxation involved with respect to corporate distributions as would the continuance of the present 4 per cent dividend credit."

2. "Moreover, from the standpoint of making funds available for investment in corporate enterprises, this reduction in tax with respect to retained earnings can be expected to have a more important impact on corporate investment than any reduction directed solely toward corporate income which is distributed."

3. "In addition, the notion that the dividend credit would encourage equity financing does not seem to be borne out by the events which have occurred since 1954. The Secretary of the Treasury has pointed out that the ratio of equity to debt financing by corporations has not increased despite the presence of the 4 per cent credit."

4. "The form of the present dividend credit, in any event, is undesirable since it reduces any double taxation by a much larger percentage for the higher income bracket stockholders than it does for those in the lower bracket."

5. "Moreover, increasing the exclusion, as the bill provides, will tend to encourage a broader stock ownership among those with relatively low income. At the same time, the repeal of the credit removes the discrimination in present law in favour of high bracket shareholders."

June 3, 1970

APPENDIX 25

The Chairman and Members
Banking, Trade and Commerce Committee,
Senate of Canada,
Parliament of Canada,
Ottawa, Canada.

Gentlemen:

Supplementary Submission of
Retail Council of Canada
to Committee of the Senate
on Banking, Trade and Commerce

When representatives of Retail Council of Canada appeared before the Committee on April 16th, 1970, a substantial part of the hearing was devoted to discussion of the tax treatment to be accorded small business. Subsequent to that discussion and in view of the line of enquiry of the Committee, further discussions on the subject took place within the appropriate committees of the Council and with the membership. As a result of these discussions, we were requested to file this supplementary submission with the Committee.

In the Council's original submission to the Committee, it was recommended that special tax treatment should continue to be accorded small business as a means of promoting economic growth and assisting in their ability to contribute to the Canadian economy. We stated that, keeping in view the charactieristics of the retail trade, the principles of the present method of tax treatment appeared fairer than any alternative suggested, so far as they related to companies truly in the "small business" category. It was indicated in our appearance before the Committee that Retail Council, in recommending perpetuation of the present system or some variant of it, was not attempting to preserve the lower rate of tax for larger companies.

In view of the discussions before the Committee and indications that the Committee is likely to favour some treatment for small business which will not provide incidental relief for larger companies, this Council determined to set out an alternative to the present system which would be acceptable to its members.

The alternative which is considered the most reasonable is one which has already been proposed to the Committee by other organisations, whereby the 21% rate of taxation is continued for corporations with a taxable income of less than $35,000. and, where income exceeds $35,000., the amount eligible for the low rate is reduced by 50¢ for every dollar of taxable income greater than $35,000.

. . . /

We believe such a system would provide the cash flow which a small and growing business requires to expand its operations and would not have the drawbacks of those proposals which, because they are based on depreciation, favour corporations in proportion to the percentage of their cost structure that is represented by depreciation. Were any depreciation based system adopted, the retail trade would fare badly under it because depreciation costs typically represent a much smaller fraction of business expense than is the case in manufacturing businesses.

We wish to add one important rider to the suggestion to the effect that the figure at which the rate of tax applied starts to increase be reviewed periodically, say, every five years, so that inflation does not erode the utility of the proposal. Precedents for this review, of course, exist: the figure at which the lower rate of tax applies having been revised upwards twice since the principle was introduced in 1949.

All of which is respectfully submitted by

RETAIL COUNCIL OF CANADA

A. J. McKichan, President

August 6th, 1970

APPENDIX 26

THE ROBERT SIMPSON COMPANY LIMITED

TORONTO, CANADA

April 27, 1970

The Chairman
The Banking, Trade and Commerce, Committee
The Senate of Canada
Ottawa

Dear Sir

SUBMISSION BY THE RETAIL COUNCIL OF CANADA
ON THE WHITE PAPER ON TAX REFORM

At our hearing on April 16, 1970, a concern was expressed by us as to the serious increase in taxation proposed by the White Paper on withdrawals from a Deferred Profit Sharing Plan. You requested specific examples of the increases, which we did not have available at that time. Enclosed is a schedule showing examples of actual withdrawals by numbers of our Profit Sharing Retirement Fund, with taxes payable as calculated under present legislation (Section 36 of the Income Tax Act) and as would be payable under the formula proposed in Section 2, 56 of the White Paper.

You will note that in every case there is substantial increase in tax payable; and that the increases are most severe on the withdrawals by those of more modest means, where one would expect that the proposed tax system would provide a lessening of the burden of taxation.

It seems clear that the income averaging formula as proposed is not equitable when applied to lump sum withdrawals from deferred profit sharing plans upon retirement of a person from employment. It will in effect impose a retroactive tax on those who entered into such a plan in good faith. When considered from the point of view of authors, athletes, or others with an irregular income pattern, but who are remaining in the income earning field, it may have merits. However, it is submitted that for a "once only" withdrawal of funds which are to provide a person with a retirement income, the present formula should be retained.

G. E. HALL
Manager - Taxation
Encl.

GEH/bd

SIMPSONS PROFIT SHARING RETIREMENT FUND

COMPARISON OF TAXES PAYABLE UPON RETIREMENT FROM FUND

PRESENT AND PROPOSED BASES

Examples	Amount Withdrawn	Present Taxes	Proposed Taxes
1. Maintenance staff, married, salary range $5,139 - $7,060	15,232	1,909	5,062
2. Maintenance staff married man with 2 dependant children, salary range $5,813 - $7,250	20,012	2,315	6,817
3. Clerk, single, no dependants, salary range $6,759 - $8,525	20,600	3,955	7,660
4. Salesman, married, salary range $7,147 - $10,029	19,441	3,252	7,158
5. Manager, married, salary range $21,500 - $25,500	23,431	7,245	11,787

These are actual examples of members who recently withdrew from our Fund, or who will withdraw in 1970. The salary range is from 1966 - 70, which would be used for the averaging formula proposed by the White Paper. Taxes have been calculated using Table 2 on page 25 of the White Paper.

APPENDIX 27

National Sea Products Limited

P. O. Box 2130
Halifax, Nova Scotia
August 20, 1970

Mr. Roland B. Breton
Executive Secretary
The Senate Committee on Banking
Trade and Commerce
1132 West Memorial Building
Wellington at Lyon
Ottawa, Ontario

Dear Mr. Breton:

On Page 25:23 of the Proceedings of the Standing Senate Committee on Banking, Trade and Commerce, No. 25, dated Wednesday, May 20, 1970, during the presentation of the Brief of National Sea Products Limited, Senator Burchill asked the following question of the Chairman, "I would like Mr. Connor to say a little more about the incentives to expand in the Atlantic Provinces as compared to the United States. We know what the advantages are today,under the present income tax legislation, but what is going to happen if the White Paper comes into effect?". Mr. Connor replied, "I have not thought this matter out beforehand, sir, but it would seem to me that we would then be in a position much like we would be in the United States, and we would have lost our relative incentive advantage to expand in Canada. This is an unschooled answer because I have not studied the facts carefully.". The Chairman then said, "Senator Burchill, suppose we leave this question up to Mr. Connor and ask him if he will address himself to it and send us a supplement to his supplementary brief?". Senator Burchill then replied, "Yes, because I think it is vital to us down in the Atlantic Provinces to have an answer to this question.". Mr. Connor agreed as follows, "We would be pleased to do that, senator.".

Our primary brief to the Committee deals, beginning on Page 2, with the effect of the proposed tax integration on investment in National's shares.

One of the important matters affecting the value of National's shares is the cash flow available to the Company. This cash flow has been enhanced for a number of years by the Canadian Government's Incentive Legislation whereby certain accelerated capital cost allowance is available on trawlers and on new plants and equipment. In the latter case, non-taxable grants have also been available under the Area Development Incentives Act, and these grants did not serve to reduce capital cost for capital cost allowance purposes. The Incentives have assisted National in acquiring new capital assets, and much of the income taxes on the earnings from these assets have been deferred because of the accelerated capital cost allowances available. The White Paper Proposals on Tax Reform will substantially negate the advantages of the deferred tax because the absence of a tax liability by National will result in higher income taxes being paid by the shareholders on dividends received from National.

The Regional Development Incentives Act,which became effective in 1969, will not, to the same extent as the Area Development Incentives Act, continue to enable National to defer income taxes. However, there will still be some measure of deferral because the depreciation rates for financial statement purposes are usually not as high as the rates allowed for capital cost allowance purposes. For example, we depreciate wooden buildings and wharves on a straight line basis of 5% per annum, whereas the capital cost allowance rates are 10% on a diminishing balance basis. Accordingly, our remarks in the preceding paragraph are still appropriate under the present legislation, but on a diminished scale.

The Corporation Income Tax rates in Canada and the United States are somewhat similar, as indicated by the following:

	Canada	U.S.A.
Income Taxes	47	48
Surtax	1.41 (3%)	4.8 (10%)
O.A.P. Tax	3	-
	51.41%	52.8%

Inasmuch as the grossing up techniques do not apply to foreign corporations which are controlled by Canadian corporations and which are located in a tax treaty country, and inasmuch as under the White Paper Proposals we cannot pass along to our shareholders the incentives which are available in Canada, there no longer

remains a preferred incentive for National to expand in the Atlantic Provinces rather than in the United States of America.

National Sea Products Limited has a ten year long term development plan involving projects costing many tens of millions of dollars, subject, of course, to our ability to raise and generate the necessary funds. It includes projects of expansion and development in both Canada and the United States, but mostly in the Atlantic Provinces of Canada. The main effect, therefore, of the implementation of the White Paper would be to change the priority of the projects planned, switching the emphasis in many cases from the Atlantic Provinces to the United States and the other parts of Canada. Some of our planned projects for the Atlantic Provinces without additional incentives would have to be dropped altogether.

On Page 25:15 of the same report, Senator Phillips stated as follows, "Following Senator Molson's point, would it be possible to obtain a statement, which in effect would be a further supplement, by way of confirmation of your supplementary submission, either from the trustees or from the union officials, confirming that these figures with respect to the five categories have been checked out by them and found to be in order. Then we will have on file not only the company's submission, but the actual views of the ultimate beneficiaries under your profit sharing plan. We will have the complete report, not only from the company but from the beneficiaries under the plan.".

This information requested by Senator Phillips is also enclosed with this letter, and we trust that it will be helpful. You will note that the five examples are different than those submitted in the original brief. The reason for this is that at the time the brief was made up, we did not have the final audited figures for the particular five examples that were given. These have since, however, been revised by audit, and you will note that the revised data makes out an even stronger case than was given in the original brief.

We trust that this information is satisfactory, but if, by any chance, further information is required we would, of course, be delighted to furnish it to the Committee.

Yours very truly,

H. P. Connor
Chairman of the Board

HPC-ac
encs.

EXAMPLE 1

WHITE PAPER

Taxable on Withdrawal $13,873.00 in 1969

Average Income		4,000
Income in Withdrawal Year		17,873
Exemptions		2,900
Taxable Income		14,973
Without Averaging		
Tax on 13,000.00	4,224.00	
1,973.00 at 42.24%	833.39	5,057
Tax on Salary		248
Tax on Lump Sum		4,809
Averaging		
Average Income		4,000
Threshold amount is average income plus 1/3		5,333
Excess of Income over threshold		12,540
Excess divided by 5		2,508
Threshold plus 1/5 excess		7,841
Tax on Threshold plus 1/5 excess Less exemptions 2900		
Tax on 4,000	1,024	
941 at 30.72%	289	1,313
Tax on Threshold Less exemptions 2900		
Tax on 2,000	473.60	
433 at 26.88%	116.39	590
Difference is tax on 1/5 excess		723
Multiply Tax on 1/5 excess 5 times = Tax on excess		3,615
Tax on Threshold amount		590
Total Tax		4,205
Tax on 4,000 Less exemptions 2900		
Tax on 1,000	224	
100 at 24.32%	24	248
Tax on Lump Sum		3,957

EXAMPLE 1

SECTION 36

Lump Sum Taxable Income $13,873

	1966	1967	1968	Total
Salary	4000	4000	4000	
Less Canada Pension Plan Conts	61.20	61.20	61.20	
Income	3939	3939	3939	11,817
Less Deductions (Exemptions & Medical)	2100	2100	2100	
Taxable Income	1839	1839	1839	
Federal Tax thereon	227	227	227	
Old Age Security Tax thereon	74	74	74	
	301	301	301	903

Rate of tax on Lump Sum of $13,873
will be $\frac{903}{11817}$ = 7.64%= $1059.89

Tax currently payable by applying Section 36 is	1060
Tax payable under White Paper Proposals	3957
Additional Tax under White Paper Proposals	2897
or an increase of 273%	

Tax on 4,000 Salary @ 1969 Rates

Salary	4000
Less Canada Pension Plan Conts	61
Income	3939
Less Deductions (Exemptions & Medical)	2100
Taxable Income	1839
Federal Tax thereon	254
Provincial Tax thereon	64
Total Tax Liability	318

EXAMPLE 2

WHITE PAPER

Taxable on Withdrawal $18,054 in 1969		
Average Income		4,000
Income in Withdrawal Year		22,054
Exemptions		1,500
Taxable Income		20,554
Without Averaging		
Tax on 16,000	5,491	
4,554 at 46.08%	2,098	7,589
Tax on Salary		608
Tax on Lump Sum		6,981
Averaging		
Average Income		4,000
Threshold amount is average income plus 1/3		5,333
Excess of Income over Threshold		16,721
Excess divided by 5		3,344
Threshold plus 1/5 excess		8,677
Tax onThreshold plus 1/5 excess Less exemptions 1500		
Tax on 7,000	1,997	
177 at 35.84%	63	2,060
Tax on Threshold Less exemptions 1500		
Tax on 3,000	742	
833 at 28.16%	235	977
Difference is tax on 1/5 excess		1,083
Multiply Tax on 1/5 excess 5 times = Tax on excess		5,415
Tax on Threshold amount		977
Total Tax		6,392
Tax on 4,000 Less exemptions 1500		
Tax on 2,000	474	
500 at 26.88%	134	608
Tax on Lump Sum		5,784

EXAMPLE 2

SECTION 36.

Lump Sum Taxable Income $18,054

	1966	1967	1968	Total
Salary	4000	4000	4000	
Less Canada Pension Plan Conts	61.20	61.20	61.20	
Income	3939	3939	3939	11,817
Less Deductions (Exemptions & Medical)	1100	1100	1100	
Taxable Income	2839	2839	2839	
Federal Tax thereon	393	393	393	
Old Age Security Tax thereon	114	114	114	
	507	507	507	1,521

Rate of tax on Lump Sum of $18,054 will be $\frac{1521}{11817}$ = 12.87% = 2,324

Tax currently payable by applying Section 36 is	2324
Tax payable under White Paper Proposals	5784
Additional Tax under White Paper Proposals or an increase of 149%	3460

Tax on Salary @ 1969 Rates

Salary	4000
Less Canada Pension Plan Conts	61
Income	3939
Less Deductions (Exemptions & Medical)	1100
	2839
Federal Tax thereon	438
Provincial Tax thereon	110
Total Tax Liability	548

EXAMPLE 3

WHITE PAPER

Taxable Income on Withdrawal 4,572 in 1969

Average Income		8,22ı
Income in Withdrawal Year		12,798
Exemptions		1,800
Taxable Income		10,998
Without Averaging		
Tax on 10,000	3,072	
998 at 38.4%	383	3,455
Tax on Salary		1,805
Tax on Lump Sum		1,650
Averaging		
Average Income		8,226
Threshold amount is average plus 1/3		10,968
Excess of Income over threshold		1,830
Excess divided by 5		366
Threshold plus 1/5 excess		11,334
Tax on Threshold plus 1/5 excess Less exemptions 1800		
Tax on 7,000	1,997	
2,534 at 35.84%	908	2,905
Tax on Threshold Less exemptions 1800		
Tax on 7,000	1,997	
2,168 at 35.84%	777	2,774
Difference is tax on 1/5 excess		131
Multiply Tax on 1/5 excess 5 times = Tax on excess		655
Tax on Threshold amount		2,744
		3,429
Tax on 8,226 Less exemptions 1800		
Tax on 5,000	1,331	
1,426 at 33.28%	474	1,805
Tax on Lump Sum		1,624

EXAMPLE 3

SECTION 36

Lump Sum Taxable Income $4,572

	1966	1967	1968	Total
Salary	8040	8240	8400	
Less Canada Pension Plan Conts	79	79	81	
Income	7961	8161	8319	24,441
Less Deductions (Exemptions & Medical)	1400	1400	1400	
Taxable Income	6561	6761	6919	
Federal Tax thereon	1196	1248	1289	
Old Age Security Tax thereon	120	240	240	
	1316	1488	1529	4,333

Rate of Tax on Lump Sum of $4572 will be $\frac{4333}{24441}$ = 17.73% = $811

Tax currently payable by applying Section 36 is	811
Tax payable under White Paper Proposals	1624
Additional Tax under White Paper Proposals or an increase of 100%	813

Tax on 8,400 Salary @ 1969 Rates

Salary	8400
Less Canada Pension Plan Conts	83
Income	8317
Less Deductions (Exemptions & Medical)	1400
Taxable Income	6917
Federal Tax thereon	1300
Provincial Tax thereon	361
Total Tax Liability	1661

EXAMPLE 4

WHITE PAPER

Taxable on Withdrawal $2,038 in 1969

Average Income		2,466
Income in Withdrawal Year		4,504
Exemptions		1,500
Taxable Income		3,004
Without Averaging		
Tax on 3,000	742	
4 at 28.16%	1	743
Tax on Salary		216
Tax on Lump Sum		527
Averaging		
Average Income		2,466
Threshold amount is average income plus 1/3		3,288
Excess of Income over Threshold		1,216
Excess divided by 5		243
Threshold plus 1/5 excess		3,531
Tax on Threshold plus 1/5 Less exemptions 1500		
Tax on 2,000	474	
31 at 26.88%	8	482
Tax on Threshold Less exemptions 1500		
Tax on 1,000	224	
788 at 24.32%	192	416
Difference is Tax on 1/5 excess		66
Multiply Tax on 1/5 excess times 5 = Tax on excess		330
Tax on Threshold amount		416
		746
Tax on 2466 Less exemptions 1500		
Tax on 500	109	
466 at 23.04%	107	216
Tax on Lump Sum		530

EXAMPLE 4

SECTION 36

Lump Sum Taxable Income $2,038

	1966	1967	1968	Total
Salary	2500	2000	2900	
Less Canada Pension Plan Conts	34.20	25.20	41.40	
Income	2466	1975	2859	7,300
Less Deductions (Exemptions & Medical)	1100	1100	1100	
Taxable Income	1366	875	1759	
Federal Tax thereon	161	96	216	
Old Age Security Tax thereon	55	35	70	
	216	131	286	633

Rate of Tax on Lump Sum of $2038 will be $\frac{633}{7300}$ = 8.67% = 177

Tax currently payable by applying Section 36 is	177
Tax payable under White Paper Proposals	530
Additional Tax under White Paper Proposals	353
or an increase of 199%	

Tax on 2,900 Salary @ 1969 Rates

Salary	2900
Less Canada Pension Plan Conts	41
Income	2859
Less Deductions (Exemptions & Medical)	1100
Taxable Income	1759
Federal Tax thereon	241
Provincial Tax thereon	60
Total Tax Liability	301

EXAMPLE 5

WHITE PAPER

Taxable on Withdrawal $5,964 in 1969

Average Income		6,000
Income in Withdrawal Year		11,964
Exemptions		2,900
Taxable Income		9,064
Without Averaging		
Tax on 7,000	1,997	
2,064 at 35.84%	739	2,736
Tax on Salary		770
Tax on Lump Sum		1,966
Averaging		
Average Income		6,000
Threshold amount is average income plus 1/3		8,000
Excess of Income over Threshold		3,964
Excess divided by 5		792
Threshold plus 1/5 excess		8,792
Tax on Threshold plus 1/5 Less exemptions 2900		
Tax on 5,000	1,331	
892 at 33.28%	297	1,628
Tax on Threshold Less exemptions 2900		
Tax on 5,000	1,331	
100 at 33.28%	33	1,364
Difference is Tax on 1/5 excess		264
Multiply Tax on 1/5 excess 5 times = Tax on excess		1,320
Tax on Threshold amount		1,364
		2,684
Tax on 6,000 Less exemptions 2900		
Tax on 3,000	742	
100 at 28.16%	28	770
Tax on Lump Sum		1,914

EXAMPLE 5

SECTION 36

Lump Sum Taxable Income $5,964

	1966	1967	1968	Total
Salary	6000	6000	6000	
Less Canada Pension Plan Conts	79	79	81	
Income	5921	5921	5919	17,761
Less Deductions (Exemptions & Medical)	2100	2100	2100	
Taxable Income	3821	3821	3819	
Federal Tax thereon	576	576	576	
Old Age Security tax thereon	120	153	153	
	696	729	729	2,154

Rate of tax on Lump sum of $5,964
will be $\frac{2154}{17761}$ = 12.13% = $723.43

Tax currently payable by applying Section 36 is	723
Tax payable under White Paper Proposals	1914
Additional Tax under White Paper Proposals	1191

or an increase of 165%

Tax on 6,000 Salary @ 1969 Rates

Salary	6000
Less Canada Pension Plan Conts	83
Income	5917
Less Deductions (Exemptions & Medical)	2100
Taxable Income	3817
Federal Tax thereon	634
Provincial Tax thereon	161
Total Tax Liability	795

Queen's Printer for Canada, Ottawa, 1970
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Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 40

WEDNESDAY, SEPTEMBER 23rd, 1970

Second and Final Proceedings on Bill C-4,

intituled:

"An Act to amend the Canada Corporations Act and other statutory provisions related to the subject matter of certain of those amendments".

WITNESSES:

Department of Consumer and Corporate Affairs: The Honourable Ron Basford, Minister; Mr. J. F. Grandy, Deputy Minister; Mr. R. Tasse, Assistant Deputy Minister (Corporate Affairs).
Department of Justice: Mr. J. W. Ryan, Director, Legislation Section; Mr. Myles Pepper, Legislation Section.

REPORT OF THE COMMITTEE

22624—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (*Rigaud*)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (*Ottawa West*)	Hays	White
Cook	Hollett	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

D

ORDER OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, June 23, 1970:

"Pursuant to the Order of the Day, the Senate resumed the debate on the motion of the Honourable Senator Urquhart, seconded by the Honourable Senator Gouin, for the second reading of the Bill C-4, intituled: "An Act to amend the Canada Corporation Act and other statutory provisions related to the subject matter of certain of those amendments".

After debate, and
The question being put on the motion, it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Urquhart moved, seconded by the Honourable Senator Gouin, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

22624—1½

MINUTES OF PROCEEDINGS

MORNING SITTING

WEDNESDAY, September 23, 1970.
(67)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 10:00 a.m. to further consider:

Bill C-4, "An Act to amend the Canada Corporations Act and other statutory provisions related to the subject matter of certain of those amendments".

Present: The Honourable Senators Hayden (*Chairman*), Aird, Beaubien, Benidickson, Connolly (*Ottawa West*), Cook, Everett, Flynn, Gelinas, Martin, Molson and Phillips (*Rigaud*)—(12).

Present, but not of the Committee: The Honourable Senator Urquhart—(1).

In attendance: E. Russell Hopkins, Law Clerk and Parliamentary Counsel.

WITNESSES:
Department of Consumer and Corporate Affairs:
The Honourable Ron Basford, Minister;
Mr. J. F. Grandy, Deputy Minister;
Mr. R. Tassé, Assistant Deputy Minister (Corporate Affairs).

Department of Justice:
Mr. J. W. Ryan, Director, Legislation Section;
Mr. Myles Pepper, Legislation Section.

The Committee proceeded to the consideration of several proposed amendments to Bill C-4.

At 12:40 p.m. the Committee adjourned.

AFTERNOON SITTING

2:00 p.m.
(68)

At 2:00 p.m. the Committee *resumed.*

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Cook, Everett, Flynn, Gelinas, Martin, Molson and Phillips (*Rigaud*)—(9).

Present, but not of the Committee: The Honourable Senator Urquhart—(1).

In attendance: E. Russell Hopkins, Law Clerk and Parliamentary Counsel.

The Committee proceeded to further consider amendments to the Bill.

At 3:45 p.m. the Committee adjourned to allow time for the Law Clerk to re-draft certain amendments.

At 4:30 p.m. the Committee *resumed.*

After discussion and upon motion it was Resolved to Report the said Bill as amended.

Amendments were made to the Bill on the following pages: 6, 7, 9, 10, 11, 14, 19, 25, 31, 39, 40, 43, 50, 52, 53, 63, 77, 81 and 106.

NOTE: The full text of the amendments appears by reference to the Report of the Committee immediately following these Minutes.

At 4:50 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

REPORT OF THE COMMITTEE

WEDNESDAY, September 23, 1970.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred Bill C-4, intitled: "An Act to amend the Canada Corporations Act and other statutory provisions related to the subject matter of certain of those amendments", has in obedience to the order of reference of June 23, 1970, examined the said Bill and now reports the same with the following amendments:

1. *Page 6:* Strike out lines 12 to 24, inclusive, and substitute therefore the following:

"(2) A company incorporated by Special Act of the Parliament of Canada

(*a*) whose objects do not include any of the objects mentioned in subsections (2) to 4) of section 5 or mentioned in sections 5A to 5C, or

(*b*) whose objects do include any of the objects referred to in paragraph (*a*) but the company has not been carrying on any of those objects for five or more years,

may apply for letters patent continuing the company under this Part if at the time of the application the company is carrying on business and the application is authorized by a resolution approved by three-fourths of the votes cast at a special general meeting of the shareholders of the company."

2. *Page 7:* Strike out line 12 and substitute therefor the following:

"ter may, by the letters patent, reduce, limit or"

3. *Pages 9 and 10:* Strike out lines 24 to 38, inclusive, on page 9, and lines 1 to 9, inclusive, on page 10, and substitute therefor the following:

"(2) The letters patent or supplementary letters patent of a public company may declare the company to be a constrained-share company when the company is one in respect of which any class or description of persons may not have a significant or controlling interest, directly or indirectly, in its shares or any class or classes thereof if

(*a*) the company is to qualify under any other Act of the Parliament of Canada or any regulations thereunder

(i) for any licence or permit to carry on or continue its undertaking or any part thereof in Canada, or

(ii) as a Canadian newspaper or periodical, or

(*b*) any other company in which the company has a direct or indirect interest through the holding of shares in other corporations is to qualify

(i) under any Act of the Parliament of Canada or any regulation thereunder for any licence or permit to carry on or continue its undertaking or any part thereof in Canada, or

(ii) as a Canadian newspaper or periodical under any Act of the Parliament of Canada.

(3) The letters patent or supplementary letters patent of a public company may declare the company to be a constrained-share company when the company is one that is incroporated with the objects of investing in the shares of other corporations and it has a significant or controlling interest directly or indirectly through the holding of shares in a federally incoporated trust, insurance, loan, small loans or sales finance company."

4. *Pages 10 and 11:* Renumber subsections (3) to (8), inclusive, of proposed section 38A as subsections (4) to (9), inclusive.

5. *Page 11:* Strike out lines 23 and 24 and substitute therefor the following:
"(9) A company that contravenes subsection (6) of this section is guilty of"

6. *Page 14:* Immediately after line 27 add, as subsection (3) of proposed new section 98, the following:

"(3) Subparagraph (iii) of paragraph (*b*) of subsection (1) does not apply to a trust company that exercises control or direction as a trustee over the equity shares of a public company carrying more than ten per cent of the voting rights attached to all equity shares of the public company for the time being outstanding unless the trustee corporation exercises such control or direction on behalf of any one person who beneficially owns, directly or indirectly, equity shares of the public company carrying more than ten per cent of the voting rights attached to all equity shares of the company for the time being outstanding."

7. *Page 19:* Strike out line 16 and substitute therefor the following:
"and who wilfully fails so to do is guilty of an"

8. *Page 25:* Strike out line 16 and substitute therefor the following:
"holders, and"

9. *Page 25:* Strike out line 21 and substitute therefor the following:
"agent, and
(*c*) to each recognized stock exchange in Canada on which the shares of the company are listed."

10. *Page 31:* Strike out line 20 and substitute therefor the following:
"(5) A person who wilfully fails to comply with"

11. *Page 39:* Immediately after line 32, add the following:
"(9) Whenever, pursuant to subsection (8), a company makes an assertion based on matters of law, the directors and officers of the company may, subject to section 106I, rely on an opinion of counsel in making such an assertion.

(10) A shareholder who, within the five calendar years preceding the meeting at which any further proposal of his is to be presented, has submitted two or more proposals that have not received the favourable vote of a majority of the votes cast in regard thereto, shall be required to deposit with any such further proposal a sum reasonably sufficient to meet the expenses of the company in submitting any such further proposal; and

(*a*) if such further proposal receives the favourable vote of a majority of the votes cast in regard thereto at the meeting of shareholders at which it is presented, the sum deposited shall be returned to the person who deposited the same; or

(b) if such further proposal does not receive the favourable vote of a majority of the votes cast in regard thereto at the meeting of shareholders at which it is presented, the sum deposited shall be used by the company to meet its expenses in connection with such proposal, and the surplus, if any, of the sum deposited shall be returned to the person who made the deposit."

12. *Page 40:* Strike out line 3 and substitute therefor the following:

"other relevant order as to the judge seems fit."

13. *Page 42:* Strike out lines 5 to 20, inclusive, and substitute therefor the following:

"112. (1) Five or more shareholders holding shares representing in the aggregate not less than one-tenth of the issued capital of the company or one-tenth of the issued shares of any class of shares of the company may apply, or the Minister on his own initiative may cause an application to be made, to the Restrictive Trade Practices Commission established under the *Combines Investigation Act* (hereinafter called the Commission), upon reasonable notice to the compaay or other interested party or *ex parte* if the Commission is of the opinion that the giving of notice would in view of the allegations made by the applicants or on behalf of the Minister unduly prejudice any investigation that might be ordered by the Commission, for an order directing an investigation of the company in respect of which the application is made."

14. *Page 42:* Strike out lines 21 to 25, inclusive, and substitute therefor the following:

"(2) Where it is shown to the Commission by the Minister or upon the solemn declaration of the applicant shareholders that there are reasonable grounds for believing that in respect of the company concerned,"

15. *Page 42:* Strike out lines 33 to 35, inclusive, and substitute therefor the following:

"have been performed wrongfully in a manner prejudicial to the interests of any shareholder;"

16. *Page 43:* Strike out line 6 and substitute therefor the following:

"fraud, misfeasance or other misconduct,"

17. *Page 43:* Strike out lines 18 to 25, inclusive, and substitute therefor the following:

"(4) Where an application is made under subsection (1) by shareholders, the applicant shareholders shall give the Minister reasonable notice thereof; and the Minister and the company or any other party who has been given notice of the application, or an authorized representative of any of them, is entitled to appear in person or by counsel to examine the application and supporting material, to cross-examine the applicants and to be heard at any hearing of the application."

18. *Page 50:* Strike out line 20 and substitute therefor the following:

"(4) Any person who wilfully fails"

19. *Page 52:* Immediately after line 14 add the following as subsection (2) of proposed section 112C:

"(2) Nothing in section 112, 112B or this section compels the production by a solicitor of a document containing a privileged communication made by or to him in that capacity or authorizes the taking of possession of any document in his possession without the consent of his client or an order of a court."

20. *Page 53:* Strike out lines 12 to 19, inclusive, and substitute therefore the following:

"(4) Upon the termination of the investigation, the Commission may order that any security given pursuant to subsection (3) be returned to the applicant but if the Commission holds that the application was vexatious or malicious it may"

21. *Page 63:* Strike out lines 6 to 13, inclusive, and substitute therefor the following:

"(4) For the purposes of paragraph (b) of subsection (3), the gross revenues and total assets of any other company with which a private company mentioned in the said paragraph (b) is affiliated within the meaning of section 121B shall be included in the gross revenue and the total assets of that private company, unless the financial statements of the private company and its affiliates, if any, are consolidated with those of a holding company that files such consolidated financial statements in accordance with paragraph (b) of subsection (1)."

22. *Page 77:* Strike out line 12 and substitute therefor the following:
"year or to both, and every person who knowingly"

23. *Page 77:* Strike out line 18 and substitute therefor the following:
"pany who knowingly authorizes, permits or acqui-"

24. *Page 81:* Strike out lines 25 to 33, inclusive, and substitute therefor the following:

"shares or class of shares of a corporation would

(i) preclude the corporation or any corporation in which it has a direct or indirect interest through the holding of shares in other corporations, as the case may be, from qualifying for any licence or permit pursuant to any Act described in subsection (2) of section 38A, or

(ii) preclude, under an Act of the Parliament of Canada, the exercise of the voting rights attached to any shares of a federally incorporated trust, insurance, loan, small loans or sales finance company held by that corporation, or any other corporation in which it holds shares, at a meeting of the shareholders of such trust, insurance, loan, small loans or sales finance company;

but if the "constrained-class""

25. *Page 106:* Renumber clause 36 as clause 37 and insert the following as new clause 36:

"36. Compliance with provincial legislation, wherever relevant, shall not exempt any company to which the *Canada Corporations Act* applies from compliance with the provisions of that Act."

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, September 23, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 10 a.m. to give further consideration to Bill C-4 to amend the Canada Corporations Act and other statutory provisions related to the subject matter of certain of those amendments.

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have returned this morning to Bill C-4, and we are at the stage where certain proposals which were discussed last week have now been put in some form that would qualify for an amendment to certain sections of the bill. Before we get down to that there is one section with which I think the minister would like to deal, and I will ask him if he will present that now. This is what we call the newspaper section, an amendment on page 38.

The Honourable Stanley Ronald Basford, M.P., Minister of Consumer and Corporate Affairs: If there are amendments to be made I would have preferred to deal with these in their order. There is one which would allow a publicly held newspaper company to become a constrained share company in order to assure that it would qualify and to continue to qualify under section 12A of the Income Tax Act. There is no immediate problem, but if we can clear it up we might as well.

The Chairman: I understand it is a problem that could arise. Constrained companies, if you recall under the proposed bill, require certain percentages of Canadian ownership or what I call Canadian content. There may be a question for public newspapers and their ownership which may vary in the market from time to time. Am I not correct that this is designed to cover that situation?

Hon. Mr. Basford: Yes, that is right.

The Chairman: In section 38A on pages 9 and 10...

Hon. Mr. Basford: I am sorry, but I thought we would deal with the other amendments first.

The Chairman: I was just giving you the priority that I feel is appropriate when the minister is here. If you wish us to continue in the ordinary way we can do it. I will certainly give you the choice. Which way would you prefer?

Hon. Mr. Basford: What I mean is that if this is the only amendment there is no point making it now because it can be cleared up later. This is what I was really getting at. There is no sense in sending the bill back to the House just to deal with newspapers.

The Chairman: I can assure you that there are other amendments to be made.

Hon. Mr. Basford: I suggest that we deal with those first.

The Chairman: We have distributed this morning to each senator a document entitled "Part A", containing the proposed amendments. I understand from Mr. Hopkins that as far as language is concerned they have been cleared with Mr. Ryan.

If you turn to page 12 of the bill, section 7, you will note a new paragraph, section 98 to the act. In subsection (1) (a) (i), lines 22 and 23 are to be struck out. This is in the definition of an "associate" which says:

> any company, wherever or however incorporated...

and it is proposed to insert:

> any other company that is incorporated under the laws of Canada or a province and of which that...

The rest of this section remains as is. This is recognizing the position which was taken in the committee last week, that "wherever or however incorporated" was reaching too far, and the suggestion was that it be limited to residents of Canada. So this is the form in which the amendment was proposed. You are proposing this, Senator Beaubien?

Senator Beaubien: Yes, Mr. Chairman. I so move.

Senator Molson: Does this cover the Massey-Ferguson point on foreign subsidiaries?

The Chairman: Yes. Is there any discussion? Is there any comment, Mr. Minister?

Hon. Mr. Basford: Yes, with your leave, Mr. Chairman, I would like to make some comments. First, while the amendment before us has been, as you suggested, seen by the Department of Justice, it is seen by them only in so far as it is a matter of proper form. There has been no determination by the Department of Justice that, in terms of policy, this is an acceptable amendment.

With great deference to honourable senators who moved the amendment, I would like to put on record some observations which may cause senators to have some reservations about the effect of this amendment. The effect of it is to restrict the definition of "associate" to companies incorporated in Canada. A company incorporated outside of Canada, even though the insider owns more than 10 per cent of the equity shares of that company, or for that matter is wholly owned by the insider, would not be an associate of the insider. Therefore, persons not connected with the company but connected in some manner with an insider, such as business associates, are susceptible more than others to receiving confidential information from an insider.

I would point out that associates are not required to report insider trading. I think that was a point that may have been misunderstood last week. The liability provisions, however, do apply to them in case of improper trading by reason of the fact that the benefits accruing to associates from insider information are valuable to the insider by virtue of his real or assumed participation in the benefits.

Without such a concept as now in Bill C-4—the purpose of which is to discourage insiders from taking advantage of confidential information in order to obtain personal financial advantage—could, if this amendment were carried, be easily circumvented by insiders being in a position to disclose confidential information to their associates, and the whole purpose of the insider scheme would be defeated by this amendment.

Mr. Chairman, I think this is very pertinent because we have had many questions, both in the House and in this committee, whether this bill is in line with provincial acts, and particularly that of Ontario and the four western provinces, which are generally uniform. In so far as we have been able to ascertain, in somewhat of a hurry, all of the provincial companies acts and securities legislation, in Ontario and in the western provinces, the uniform Ontario and Western acts, do include in their definition of associates any company wherever or however incorporated—simply to avoid the loophole that would be created by this amendment.

The fact that the definition of associates within the Ontario act and the uniform western provincial acts includes these companies, within associates, wherever incorporated, does not appear to have created any great difficulty.

To restrict the definition of associates in the federal act, in this act, to companies incorporated in Canada, would not only create confusion—because of some companies still being caught by the definition of associates in the provincial legislation, provincial securities legislation, for example—but it would constitute an important loophole, as I said, in the act. It would create confusion for those companies who may have to meet the requirements of provincial securities acts and the federal act. They would not know which one to comply with, because each would be different in so far as the definition of associate was concerned—the provincial acts, as I say, including the foreign company and the federal act, if this amendment were carried, not including the foreign company. Also, it would create the loophole I mentioned.

For example, Mr. Chairman, an insider could set up a company in the United States, through which he could trade in the securities of the Canadian company in which he is an insider. The improper benefit derived by the associated company in the United States, the United States incorporated company, would not, if this amendment were made, be recoverable. That surely would create a very large loophole.

The associates are not required, and I emphasize this point, to report their trading in securities of the company. The purpose of this definition is for the purposes of the liability provisions, which do extend to them. The fact that the associate is a resident of another country might raise some difficulties if proceedings of a civil nature were initiated. These, of course, pertain to the domain of private international law and the fact that

there might be difficulties of this nature should not, however, be sufficient to deprive a person in Canada from exercising a claim that it might have against a resident of another country.

The definition within Bill C-4 is similar to that in the Ontario and the western acts. To create a definition of associate within our act that is different in so far as the foreign companies are concerned is, in my very serious submission, Mr. Chairman, could create a very serious loophole in the insider trading provisions. I think that senators will find even more important the point that it could create considerable confusion for those companies which would have to decide which act to comply with, which insider regime to comply with, whether the Ontario one or the federal one.

The Chairman: Mr. Minister, I anticipated most of the things you have said. Let us start with the principle, and the important thing, as far as I am concerned. The insider will be in Canada. Is that right?

Hon. Mr. Basford: Yes.

The Chairman: And the insider, under the statute, has definite obligations and he has to report his trading.

Hon. Mr. Basford: Yes.

The Chairman: Therefore, if the insider adopts a devious scheme by creating a company outside of Canada, you have the insider that you can get at here. Even if you leave this definition in, in the form in which it is, you would not effectively be in a position in the foreign country to sue, no matter what the liability you might think the associate had under this section of the bill.

Also, Mr. Minister, you talk about confusion. I do not see how there could be any more confusion on this particular point than the general confusion that it might be suggested will exist when a federally incorporated company will find that it has to make all the filings required under Bill C-4 and then must make all the filings required under the provincial securities law.

If they are able to interpret that, they will certainly know in which form they deal with the associate according to the definition in that act. If it is provincial, the forms are clear: if it is federal, I assume the forms will be clear. So I do not see any risk of confusion. There might be a sense of frustration in having to file two returns, but this is something that apparently this bill is designed to require for federally incorporated companies.

You did admit yourself, Mr. Minister, that you want this provision in, whether it can be effective so far as any action to recover in respect of any liability that it creates, against some person resident in another country. I think that is a correct statement of the law, that you would not be in a position, but you would have the insider here, against whom the main thrust can be made. So far as his operating as you suggested, by setting up a company in another country, this company, if he is in control of it, could be construed as his agent and you could take all your proceedings here. And you do not need this particular definition in order to be able to do that.

Hon. Mr. Basford: Mr. Chairman, I think the filing requirements are dealt with both under the exemption provisions in this act and the exemption provisions in the various provincial acts. I think what we are concerned with here is the civil liability, the liability of the insider, and I suggest that, with this amendment, the liability would be stated differently, depending on whether you looked at the federal act or the provincial act where the trading took place, and that the two laws would create or appear to create different liabilities. I suggest that is a situation which we should endeavour to avoid, because the federal act would create one set of liabilities as to who are or are not associates; but a provincial act may govern where a trade takes place, and it would create a different set of liabilities.

The Chairman: I do not accept that argument in the form in which you present it, Mr. Minister, because if, in the illustration you made, the insider is the master and the vehicle he uses outside Canada is his agent, then you have the insider the master in Canada fully liable because, if he does not disclose what he is doing or causing his agent to do, then he is in violation of the terms relating to an insider and to the filing requirements an insider must make.

Senator Cook: Mr. Chairman, I do not see why "insider" cannot be left as it is in the act. If the foreign company is his agent and that is put in the act, that would cover it, would it not? In other words, it would be an error under the act as it is now.

Senator Flynn: Was the point last week to the effect that the director of an associate company who would be a foreigner would have some obligations under this act without knowing that he had such obligations? Is that the point we were trying to cover?

Mr. E. Russell Hopkins, Law Clerk and Parliamentary Counsel: There was no question as to the constitutionality of it.

Senator Flynn: No. I am referring to trying to apply Canadian law to a person living outside Canada; I am not talking of a corporation. Suppose a director of a French incorporated company, which is a subsidiary of a Canadian company, has some personal liability under this act. He might not be in a position to discharge those duties or liabilities. I thought that was the point we were trying to solve here.

Mr. Hopkins: It was on the question of the effectiveness; how effective it was.

Senator Flynn: If I do not know and you are trying to reach me but do not, I do not know that you are trying to.

The Chairman: The point that was made here was that this was providing a definition of an associate which would reach out and include a company anywhere in the world, incorporated under the jurisdiction of any country in the world. I can remember the newspaper critics—and some of them had almost an authoritative source—when the United States, in some effort to enforce its tax laws, took some action or other against a Canadian company. There was quite a storm of protest. This is exactly that situation. It is a step that is ineffective. It still leaves us having to penalize the man who has originated it. That is the man who is here and subject to our jurisdiction. So what are we trying to fool ourselves about? We are taking a broader range of definition than we can make effective use of. That is the real point in it.

Senator Phillips (Rigaud): Mr. Chairman, we speak in subsection (a) of "associate" when used to indicate a relationship with any person. Are we referring to a person resident in Canada or in this instance are we also referring to a person who is not a resident in Canada? I put that question because if we were referring to a person resident in Canada, then it changes the entire aspect of the problem.

Hon. Mr. Basford: The person is an insider. Whether he is an insider or not depends on his position in the company. His position in the company does not necessarily depend upon residency.

Senator Cook: He must be an insider in a Canadian Company.

Hon. Mr. Basford: In a Canadian-incorporated company, yes.

Senator Cook: It does not matter where he lives or what he does.

Hon. Mr. Basford: That is correct. But I want to be careful in the way of wording that. He could be the president of the Canadian company but resident in New York.

Senator Urquhart: The objection I have noted in my notes here from discussion two weeks ago is that since the Canada Corporations Act only applies to federally incorporated companies the words "whenever and however incorporated" would take in companies that were incorporated under provincial law; and that created a constitutional issue between the federal and provincial authorities. That was the objection that I had noted here. Have we gone beyond that now with this amendment?

The Chairman: Yes, we have, because it is the question of the kind of liability that is being created. There is an offence, I would assume, provided for in this bill in relation to an item of this kind.

Certainly, if it is criminal law in its nature, whether it was a provincial company or a federal company would not matter. In order to avoid any consequence of that kind, therefore, the amendment was restrictive, in providing that they could not extend the definition of an associate to some person who was not a resident of Canada.

Senator Everett: Mr. Chairman, could not items (ii), (iii) and (iv) of that same section refer to persons not resident in Canada? That is, partners, trusts, estates and so on.

The Chairman: It could include in (ii) any partner of that person acting by or for the partnership of which they are both partners.

Senator Everett: I would make that point. Since items (ii), (iii) and (iv) can refer to non-residents, it would seem to me that it is not very important that you include in the definition "non-resident incorporations". It might be another matter whether or not the act is enforceable against those non-resident incorporations or indeed against non-residents.

But you may exclude non-resident incorporations by the language of your amendment.

The Chairman: I am wondering whether you are reading that correctly, Senator Everett? Paragraph (iii) says any partner of that person, and that person must go back to (i). If you restrict the company incorporated to a company incorporated in Canada or in a province of Canada, then any partner of that person—

Senator Everett: I am afraid I do not agree with you, Mr. Chairman. It refers back to the word "person" in 98. (1) (a).

Hon. Mr. Basford: The associate of a person can be a company, a partner, a trust or a spouse, son or daughter.

The Chairman: Well, the only conclusion that would develop out of your interpretation of that, Senator Everett, would be that the restriction should apply to all the enumerations.

Senator Everett: That is my point. In order to make your point effective, you would have to exclude non-resident partners, non-resident estates and trusts and so on and so forth, and you probably would not want to do that.

The Chairman: We got thinking in terms of companies, because this was the manner in which the point was presented on behalf of a company.

Senator Everett: Yes.

Senator Cook: That would make the minister's observation doubly effective. All they would have to do would be to leave Canada in order to violate the Act.

The Chairman: But leaving Canada would not accomplish it. You would have to change your residence. This has been done before, and no matter what you do, it will continue to be done.

Senator Everett: The point I was trying to make is that the amendment would not be effective except against companies incorporated outside the laws of Canada or the laws of one of the provinces and therefore would not be effective against those persons mentioned in the other subsections.

The Chairman: Are you suggesting that (ii), (iii) and (iv) should have the same qualification, that is "persons ordinarily resident in Canada"?

Senator Everett: No, I am suggesting that we do not pass this amendment. The reason it is proposed, as I understand it, is that it may appear to others that we are going beyond our jurisdiction. It is purely a matter of appearance and in the end we would have to deal with whether or not an action was taken against a non-resident person or corporation. If the terms of the Act do not permit the Crown to take that action, then nothing is lost.

The Chairman: It is one approach to drafting legislation, senator—that it won't hurt.

Senator Connolly (Ottawa West): Surely having regard to the jurisdiction that the federal Government has in respect of criminal law both the amendment and the wording of the section are not *ultra vires* of the criminal jurisdiction that resides in this Parliament. So from that point of view both the amendment and the original form are valid. At this stage I must apologize for coming in late, but it seems to me from what little of the discussion I have heard that if you have a person who becomes an insider as a result of the definitions given in the act as drafted, then whether he resides in Canada or not, if he comes here and violates the act, surely he is amenable to the criminal jurisdiction whether the company in question is incorporated elsewhere or not.

The Chairman: The fact that you are a non-resident does not give you immunity to the criminal law of Canada if they can get hold of you. However, if you do not come into Canada, the criminal law is not effective unless it is a matter involving extradition.

Hon. Mr. Basford: Mr. Chairman, I think, with respect, that Senator Everett has raised a very valid point and one that would, if this amendment carried, create quite an anomaly that would be difficult to explain. We create under the Act a liability on insiders using confidential information and we extend the meaning of "insider" to include "associate" so that the insider and his associates are liable for any profit derived from the use of insider information, and the associate of an insider becomes, as set out in this section, any company, any partner, any trust or any spouse, son or daughter. If the amendment were to carry it would mean that non-resident corporations were not associates and therefore non-resident corporations could be associated with insiders and could profit from confidential information without liability, but non-resident partners or non-resident trusts or estates could not.

You could, for example, transfer an estate from a Canadian trust company to a New York trust company and avoid the incidence of the section, or two brothers, one of whom was resident in Canada and one of whom who was not resident in Canada—one would be an associate and the other, if you follow the same logic, would not be. By this amendment you create a real anomaly in the act. So I go back with respect to what I said before that this definition is the same as used by the Ontario act, which has not, with due respect to Massey-Ferguson who raised the point, created any difficulties.

The Chairman: There is no question but that the amendment in the form in which it is proposed would create difficulty and conflict as between (ii), (iii) and (iv) as against (i). There is no question about that; it is obvious. Senator Connolly has raised a point which may be very interesting and indeed very valid. If a person who is in cahoots with an insider is a non-resident, and comes into Canada while he is in Canada he is of course within the jurisdiction of Canadian authorities. Under this section in the form in which it is now set down, if the authority were well aware of what was going on they would have an opportunity, by physically having the person here, to take proceedings under the act if the section remained in the form in which it is at present. What your remedy would be if we were to change the section in line with the suggestion made is a matter of speculation. It might have to involve a charge of conspiracy including the insider and these non-residents. I am not keen to carry the torch for non-residents any more than we should have an effective law here, but against that possibility I agree that if any of these people named in the section come into Canada, and this section were to remain in its present form, they could be proceeded against. Perhaps that is a good reason for not changing it. In the light of the discussion—I do not want to label this as your amendment, Senator Beaubien—

Senator Beaubien: I understand part of it. I will withdraw it.

Senator Molson: Mr. Chairman, I do not believe that Massey-Ferguson were asking for or deserve any special consideration, but they did point out a couple of problems in this sphere. I think in the actual mechanics of the thing it creates more difficulty for Canadian international companies, who, I think, might be acting in perfectly good faith in the normal course of events than perhaps it does for individuals who, one is tempted to think, might be acting in poor faith if they got involved in this situation.

The Chairman: No, I would think, Senator Molson, the Massey-Ferguson point bears more on the next point that we are going to consider. That is to say, they said, "We have 86 companies incorporated in various jurisdictions around the world. If the directors and officers of those companies are put in the category of insiders, it rates an impossible situation." In an attempt to deal with that, we did prepare an amendment.

Senator Connolly (Ottawa West): Have you finished with this one?

The Chairman: Yes. Is this the view of the committee, that this section stand in the form in which it appears in the bill?

Hon. Senators: Agreed.

The Chairman: On page 14, line 7—this more directly relates to Massey-Ferguson—the proposal was after the words "every director or officer" to insert the words "ordinarily resident in Canada". This was designed to meet the Massey-Ferguson situation. Have you any comment on that, Mr. Minister?

Senator Martin: That is after the word "officer"?

The Chairman: Yes.

Hon. Mr. Basford: Mr. Chairman, yes, if I may make a comment—and I am not trying to be obstructionist, but—

Senator Connolly (Ottawa West): You did well on the first point.

Hon. Mr. Basford: The effect of this amendment would be to restrict the meaning of section 98(2)(b) to only those officers and directors resident in Canada.

I would like to point out that an amendment was made to Bill C-4 in the Committee in the other place, that the directors and officers of a subsidiary shareholder be deemed to be an insider of its holding company. Not at my suggestion, but as a result of the testimony of Mr. Purdy Crawford, a solicitor from Toronto, whom I suspect is known to you, Mr. Chairman—he being with the firm of Osler, Hoskin & Harcourt—Mr. Crawford was one of the two joint secretaries of the Kimber Committee, and, as such, he made substantial

contributions to the drafting of the Ontario legislation. I would like to quote, if I may, from his evidence in the other place, where Mr. Crawford said:

> Speaking very generally, Mr. Chairman, this is a technical defect we think exists in the Ontario legislation. You can be an insider of a company in Ontario by virtue of being an officer of a subsidiary. Unless the parent of the subsidiary is...

Senator Connolly (Ottawa West): Could you read it more slowly, please?

Hon. Mr. Basford: Yes. I have difficulty with it, too.

> You can be an insider of a company in Ontario by virtue of being an officer of a subsidiary. Unless the parent of the subsidiary is controlled by a grandparent you are ont an insider of the parent but you are an insider of all other subsidiaries of the parent so this is obviously a very technical matter. We suggest that the section should provide that a subsidiary is deemed to be an insider of its parent. If I can illustrate it in practical terms, you would be liable for improper insider trading in the shares of a brother or sister company but you would not be liable for improper insider trading in the shares of a parent company.

The concern has been expressed, as your Chairman has pointed out, by Massey-Ferguson—and it might be said of other large companies too—that it would not be possible to enforce the filing requirements in the case of subsidiaries established in far-away countries. I would like to point out, Mr. Chairman, that there are exemption procedures provided in the bill, and I think they can provide the relief that is required. We understand that in somewhat similar circumstances this was being done in Ontario and the other provinces that have followed the Ontario legislation.

The Chairman: Mr. Minister, there was a very simple answer I expected you might make to this. That it that having agreed to let the previous section stand, we would be creating a conflict if we then made the proposed amendment to this section.

Senator Aird: I think that is the correct position. Surely, the two stand together.

The Chairman: Yes, the two stand together or the two fall together, notwithstanding what Mr. Crawford said.

Hon. Mr. Basford: If you, as Chairman, see it that way, I see it that way.

The Chairman: Well, you heard Senator Aird agree with that position.

I brought this point up because Massey-Ferguson had raised it, in an effort to relieve them of a situation which may be a very troublesome one, having to do so much in the way of paper work, but the minister has indicated that there are exemption provisions, and maybe that is where we look for relief.

Senator Connolly (Ottawa West): So the second proposed amendment is gone?

The Chairman: Well, we discussed it without actually making it a matter of a motion, so we simply passed the section.

Then, page 25, of the proposal...

Senator Connolly (Ottawa West): You are going to have to give something sometime, Mr. Minister!

The Chairman: Do not worry, we are building up.

Hon. Mr. Basford: I have already suggested two myself.

The Chairman: We will do all right before we are through.

On page 25, the new section 103, which is part of Clause 8, in subsection (2), which deals with a notice of record date, there may be a record date so far as your right to vote shares at a meeting of shareholders is concerned. Many companies have that provision, where they set a record date, and if you are on the register on that date you qualify to vote. If you acquire shares subsequently, then you do not qualify to vote.

The suggestion was made in paragraph (b) that in addition to notifying each shareholder, although this is disjunctive, I am going to propose that (a) and (b) should be joined by "and" instead of "or" because it is a very important thing for a shareholder to know. Therefore, every means of communication should be used to let him know when his voting right is cut off.

There were two things suggested here last time. I think Senator Beaubien suggested that any stock exchange in Canada on which these shares are listed should be notified as to the record date.

Senator Beaubien: That is right.

The Chairman: I am suggesting that in addition we change the "or" to "and" between (a) and (b), so that the shareholder must receive notice and there must be an advertisement; and then another "and" and you put in a paragraph (c) which says:

> "to each recognized stock exchange in Canada on which the shares of the company are listed."

Senator Flynn: The way the amendment was drafted it was "or" and you want "and"?

The Chairman: No, it is "and".

Senator Flynn: I see.

The Chairman: I think every vehicle possible should be used to let them know because this may be, in one sense, a denial of what a shareholder ordinarily thinks, that he has a voting right. I have been in situations where this difficulty has arisen. True, if you read your certificate you will know, but I think every means possible of communication should be given.

Now, Mr. Minister, we have allied ourselves on the side of the angels. What have you to say against this proposal?

Hon. Mr. Basford: Well, I am taken by surprise by your latest suggestion of changing the "or" to "and". While you are on the side of the angels, I am afraid that I am going to have to be on the side of the corporate managers of Canada, because I can see this placing a rather considerable burden on them.

I agree with the concept that the purpose should be to allow an opportunity for the shareholders to know the date of record, but to impose upon the managers of companies three obligations—one of notifying the stock exchange, one of advertising in a newspaper, and one of mailing notices to shareholders—is, I think, unnecessarily burdensome. Surely, if it is mailed to shareholders then that is sufficient notice to the shareholders.

I am not generally regarded in this committee, I think, as a spokesman for managers, but I must say that. If the Senate wants to place that obligation upon managers then I suppose it is free to do so.

Senator Connolly (Ottawa West): I think there are four obligations. Some shareholders never read the newspapers, and they could proceed under (b) and not (a).

Senator Molson: Yes, (b) is not a substitute for mailing the notice.

The Chairman: If the word "or" is there, then it is.

Senator Molson: I mean it should not be considered as a suitable substitute for (a), because it is not an adequate notice in my view.

Senator Beaubien: It has got to be "and", and the stock exchange should be notified. It is being notified now. If a stock is listed on the stock exchange, and the exchange is not notified then it would delist the stock. It should be in the act, I think.

Senator Connolly (Ottawa West): I know that the minister has a practical problem in the House of Commons. Being on this side, I think, should not create any problem for him.

Hon. Mr. Basford: No, it creates no problems for me.

Senator Connolly (Ottawa West): But does not the minister agree that if the word "or" is used then (b) becomes a substitute? It will be the only thing they will use because it is cheaper.

The Chairman: I am proposing "and".

Senator Connolly (Ottawa West): Yes, but you have the word "or" there now.

Senator Beaubien: No, we have "and" now.

Senator Aird: Senator Connolly's point is that (b) might be used as a complete substitute for (a).

Senator Connolly (Ottawa West): That is right, and it would be perfectly proper for them to do it.

The Chairman: Yes, it is not really adequate notice. Does the amendment stay on the side of angels, Mr. Minister, or have you anything further to say?

Hon. Mr. Basford: No, I have nothing further to say.

The Chairman: What is the view of the committee? Does the committee support the amendment?

Senator Flynn: The question was whether we should have "and" at the end of (a). Should we require advertising and notice to the stock exchange, or should it be one or the other?

Senator Beaubien: No, the notice should be to the stock exchange in all cases.

Senator Flynn: What about advertising in the newspapers?

Senator Connolly (Ottawa West): Surely, there are very few stock exchanges, and that applies only when the company's shares are listed. It is probably only a matter of another six cents.

The Chairman: Then this amendment is: Change the word "or" in subparagraph (a) in subsection (2) to "and"; then after subparagraph (b) put in the word (or); and then add a new subparagraph (c) which reads: "to each recognized stock exchange in Canada on which the shares of the company are listed". Is that agreed?

Hon. Senators: Agreed.

Senator Everett: Mr. Chairman, I am in favour of the amendment, but I am wondering what happens to a shareholder who on the record date no longer holds a beneficial interest in the company. Under the terms of the act is he entitled to vote?

Senator Flynn: No, I do not think so.

Senator Everett: He has no beneficial interest.

Senator Flynn: It is not because of the act that he would be entitled to vote. He has no shares, so he is not qualified any more. You are disqualifying the new shareholder who acquires his shares after the date, but that does not give the right to vote to someone who has disposed of his shares in the meantime.

Senator Molson: But what if he has filed a proxy?

Senator Flynn: Yes, you have no control. It is up to the company here. It is a problem of trying to simplify the procedure for the company. It is up to the company to check on all the transfers made after the date.

Senator Everett: I agree that it is up to the company, according to the way I read this, but I am wondering if there is some provision that would allow a beneficial owner subsequent to the record date to have his ownership recorded if he chooses to attend the shareholders' meeting? If that is not so, then is the antithesis true? Is an owner who has sold his beneficial ownership entitled to attend the shareholders' meeting, or to deliver a proxy, and thereby influence the conduct of the affairs of the company without having any beneficial ownership?

The Chairman: That is a different question, senator.

Senator Everett: I realize that, it just came to my mind that I might bring it to the minister's attention as a dangerous departure from corporate law. The act may not intend it, but...

The Chairman: Senator Everett, with respect to the matter of closing your transfer sheets, and saying at a certain instant, "These are the people who are qualified to vote," I would say that the bylaws of the company provide that the company recognizes for all purposes the shareholders of record. I do not know how a company could do otherwise.

Senator Flynn: But that does not give the right to vote to one who has disposed of his shares before the annual meeting.

The Chairman: Usually the transfer books are closed in that period.

Hon. Mr. Basford: The answer to both of Senator Everett's questions is: No. That is an offhand answer, without taking advice.

Senator Beaubien: I remember in 1936 when the province was taking over Montreal Light, Heat and Power, that some shareholders who had bought stock after the record date came to the meeting and presented their shares, and voted them. I may be wrong, but that is my recollection. They brought the shares to the meeting, and they voted them.

Senator Flynn: But not with this section.

The Chairman: I suspect that that was making assurance doubly sure.

Senator Everett: I am not sure of my ground. I just wanted to bring to the minister's attention the possibility that the act might operate in this way.

Senator Flynn: The other side of the story, I think, is that if somebody sells his shares before the meeting then he has not the right to vote.

Senator Connolly (Ottawa West): But he may have sent in his proxy before he sold.

Senator Flynn: That is right. It is a problem for the company.

Senator Connolly (Ottawa West): Perhaps one of the minister's officials would say what the situation is. Suppose a beneficial shareholder sent in his proxy and then after the register was closed sold his shares to me, and then suppose that I go to the meeting. What is the situation then? I have my shares.

Senator Flynn: Yes, but you cannot vote.

Mr. J. W. Ryan, Director, Legislation Section, Department of Justice: Mr. Chairman, may I read section 102 as it is on page 24 of the bill:

> Subject to section 103...

That is the setting of the record date.

> ...and in the absence of other provisions in that behalf in the letters patent or supplementary letters patent, at all meetings of shareholders every shareholder is entitled to give one vote for each share then held by him, but no shareholder in arrears in respect of any call is entitled to vote at any meeting.

Senator Molson: But that is subject to section 102.

Mr. Ryan: Yes, that is where you send the notice of the time and place of the meeting. You send a list to whom you make the notification of the time and place of the meeting, and you are then sort of saved from sending notices to persons who subsequently become shareholders, and of whom you have no record at that time.

Senator Connolly (Ottawa West): Yes.

Senator Molson: On this basis you could have more than 100 per cent of votes at the meeting. If you have proxies in from people who cease to be shareholders and you have new purchasers of shares who register their shares on that, theoretically you could have 101 per cent of the shareholders' list vote.

Senator Beaubien: If you vote your shares they would have to go to the register and cancel the proxy.

Senator Aird: May I direct a question to Mr. Ryan? He has just read out section 102. The query I would like to make is why do you use the word "held" instead of owned?

The Chairman: I would object to both them and I would say it should be of record.

Senator Aird: I do not know if Mr. Ryan heard my question.

Mr. Ryan: I did not.

Senator Aird: It seems to me that the word "held" raises problems. It raises the problem we have just been discussing.

The Chairman: On that point, Senator Aird, the present section 102 in the act uses the word "owned".

Senator Aird: Perhaps there is a reason for the change.

Mr. Ryan: I do not know, but it seems to be more hold than held in the act than owned, which carries the connotation of a legal ownership or a beneficial ownership. Held is more frequently used in this sense of the share in an individual case, because he may not be the owner of it in the beneficial sense.

The Chairman: Mr. Ryan, I raise the question as to why use either owned or held. Why shouldn't it be of record? The register is the voters' list.

Senator Flynn: Registered in his name in fact.

Senator Connolly (Ottawa West): Suppose the register is closed and the transfer nevertheless takes place. It could even be an over-the-counter sale. You then have a beneficial ownership which is not of record perhaps, although no doubt the buyer would try to get his shares registered and certainly notify the company that he had acquired it.

The Chairman: But, the escape is really in the opening words of section 102 as proposed. The company's by-laws are very specific. You will note that it says:

> Subject to section 103, and in the absence of other provisions in that behalf in the letters patent or supplementary letters patent.

You would have to put your voting provisions in your letters patent or supplementary letters patent.

Mr. Ryan: May I correct an observation I made earlier when I read section 102 without paying sufficient attention to section 103 as follows:

> (1) The directors of a company may, by resolution, fix a record date for determining the shareholders who will be entitled to vote at meetings of shareholders.

Therefore, Senator Molson's point is well taken.

The Chairman: That is right. The directors by resolution can set a record and determine the voters...

Senator Flynn: They can take away the vote of a shareholder who acquires his shares after a certain date?

The Chairman: That is right.

Senator Flynn: That is the only thing they can do. It does not give the right of the vote to one who sells his share before the meeting and after the date.

The Chairman: No.

Senator Connolly (Ottawa West): I am not too sure, in the light of what Mr. Ryan has said, because he says Senator Molson's observation was correct. His observation was to the effect that you would have perhaps 102 per cent of the shareholders voting. There is nothing to correct this.

Senator Flynn: That is not what he meant. He did not mean that he was right in saying that, but that he was right when he pointed out that the witness had intimated this would be the result of his interpretation, which he has corrected now.

Mr. Ryan: That is right.

The Chairman: We have had an interesting discussion after we passed the amendment.

Senator Benidickson: Have we a definition of recognized stock exchange?

The Chairman: I would think if the question came up in a court of law it would be very easy to determine.

Senator Phillips (Rigaud): If they consistently lose money.

The Chairman: We now move on to page 39. In the course of hearing representations the other day in these paragraphs, starting with subsection 6 on page 38, we dealt with the obligations of the company where a shareholder has put forward a proposal to the company and the obligation of the company to include that proposal in the information circular which they may send out in connection with the annual meeting of shareholders.

There were two things suggested, one of which is found in subparagraph (8) on page 39. It says:

> Whenever a company asserts that a proposal and any statement in support thereof may properly be omitted from its information circular and form of proxy, the company shall, within fourteen days after its receipt of the proposal, notify the shareholder submitting the proposal of its intention to omit the proposal from the information circular and form of proxy and shall forward to him a statement of the reasons why the company deems the omission of the proposal to be proper.

As a protection to the company the proposal was that if the assertion of the company is made in connection with the local matter on the basis of the advice of counsel, that that is a good answer for the company. The thing does not end there, because in section 106(1), which is proposed, it says that the minister or any person has failed to have his proposal included, he is given the right to apply to the chief justice or acting chief justice of the court of the province in which the head office of the company is located for an order requiring that this be done.

It does give some protection in the first instance against frivolous and vexatious proceedings by a disgruntled shareholder who has, as very often the case, put forward a very irrational sort of proposal. This is the type of an amendment that is proposed, that there be added subsection (9) immediately following subsection (8):

> (9) Whenever, pursuant to subsection (8), a company makes an assertion based on matters of law, the directors and officers of the company may, subject to section 106I, rely on an opinion of counsel in making such an assertion.

There is also a proposal that we add subsection (10), which would read in this fashion. It deals with a shareholder who puts forward another proposal. At some time it is felt that he should have to put up some money if he is going to continue making types of proposals such as this. Subsection (10) is intended to do as follows:

> (10) A shareholder who, within the five calendar years preceding the meeting at which any further proposal of his is to be presented, has submitted two or more proposals that have not received the favourable vote of a majority of the votes cast in regard thereto, shall be required to deposit with any such further proposal a sum reasonably sufficient to meet the expenses of the company in giving effect to any such further proposal; and

(a) if such further proposal receives the favourable vote of a majority of the votes cast in regard thereto at the meeting of shareholders at which it is presented, the sum deposited shall be returned to the person who deposited the same; or

(b) if such further proposal does not receive the favourable vote of a majority of the votes cast in regard thereto at the meeting of shareholders at which it is presented, the sum deposited shall be used by the company to meet its expenses in connection with such proposal, and the surplus, if any, of the sum deposited shall be returned to the person who made the deposit.

The basis of this is that there should be some control at some stage where it is not just a free ride for any shareholder to put forward any kind of proposal. If he has put two forward in five years, and neither one has carried the favourable vote, then the next time he puts it forward he should have to put up some money.

Senator Flynn: You want to create a presumption that he is trying to make a nuisance of himself.

The Chairman: It might be a logical presumption.

Senator Flynn: On the question of wording, in the last line before (a) there is "giving effect to any such further proposal". I think what you have in mind is "in submitting such proposal to shareholders" instead of "giving effect to such proposal".

The Chairman: Yes, I think that is correct. Strike out "giving effect to" and insert "in submitting".

Senator Flynn: It is not the cost of giving effect to it but in submitting it.

Senator Molson: Why should he have to have two bashes at it, Mr. Chairman?

Senator Beaubien: Two free.

Senator Connolly (Ottawa West): On the principle that on the third strike you are out.

Senator Molson: That is a good sporting plan, but I do not know that this is in the sporting field. You get these not bona fide interested shareholders, these perennially difficult people, who come up with ideas that they really have not any faith in at all. I do not know whether the idea of two or more is necessarily right.

Senator Flynn: An alternative may be that the directors could apply to a judge to decide in each case whether the proposal should be accompanied by a deposit.

Senator Beaubien: That would be expensive.

The Chairman: It might mean making it too important.

Senator Molson: It takes too long, too.

The Chairman: Yes.

Senator Molson: It would become impossible to get the annual meeting off the ground if you had to go through all these things.

Senator Flynn: It would be a very simple procedure.

Senator Beaubien: What do you do now?

Senator Gelinas: Who would decide on the amount and how it is arrived at?

Senator Flynn: You calculate the expenses and the cost.

The Chairman: Senator Gelinas, I would think that if a shareholder is able to draft a proposal, and if this is his third one, it may be that it is time he should have some idea of what the cost was or that he should ask the company what the cost is likely to be.

Senator Flynn: Senator Gelinas was asking who is going to determine. The company is going to determine the cost of calling the meeting, I suppose.

Senator Gelinas: Not calling the meeting, but to study the proposal, to have legal counsel and everything that goes along with it.

Senator Martin: Mr. Chairman, what is the practice in other jurisdictions—in Ontario or in the United States?

The Chairman: By other jurisdictions, do you mean provincial jurisdictions?

Senator Martin: Yes, Ontario and other jurisdictions.

Senator Beaubien: Ontario has something about putting up some money, does it not?

Hon. Mr. Basford: This point on the shareholder initiative is a fairly new one, it is new in Bill C-4, and it is moulded after the American practice. We have put into it—and it was amended in the house committee—a good number of safeguards, more safeguards

than exist in the American procedures. You will see these safeguards on page 38, in subsection (6).

The Chairman: That is right.

Hon. Mr. Basford: This is in order to avoid the frivolous and the silly and the crank complaints by which both people could force a company to submit their proposals to its shareholders. There were amendments made in the house for the purpose of making sure of that point. I have no difficulty with the second suggested amendment here, senators, and at an opportune time I would address myself to it, but I have some difficulty with the first one.

The Chairman: Now is the time.

Hon. Mr. Basford: There is no particular Ontario practice.

Senator Beaubien: I remember reading somewhere that it was put in.

Senator Connolly (Ottawa West): Are you not talking now about the opinion of counsel?

Hon. Mr. Basford: Mr. Chairman, with regard to this amendment I have no difficulty at all with the part entitled "deposit for further proposals" requiring on a third time that they be required to put up the costs. That is simply an additional safeguard. We have put in safeguards. There are safeguards in subsection (6) to which I would draw your attention. This would constitute another safeguard, to protect legitimate management against a crank shareholder.

I have difficulty with subsection (9), not because of the concept of it but just as to precisely what it means, or the effect of it, which I think is a little difficult.

It is very clear, under subsection (9) as it is presently worded, that, even with the opinion of counsel, it would not be helpful to the company, in the case where the later section 106I applies, that is, the company would have opinion of its counsel that it need not include this proposal in its notice—the shareholder could go to court and get an order that it be included, as I read the act. So I am not sure what effect this opinion of counsel has.

The Chairman: They would have a good defense if they were being sued for failure to include the proposal. The suggestion might be that the reasons given are inadequate. If a counsel advises them on a matter of law involved in it, then that is a protection to them.

Hon. Mr. Basford: I see.

Senator Phillips (Rigaud): Mr. Minister, through the chair, if an application is made to do something which in the opinion of counsel for the company is ultra vires of the powers of the company, the directors and officers of the company would be in a protected position with such a section—even if subsequently it were found that it was not ultra vires the powers—but at least the officers and directors acted on the advice of counsel.

Hon. Mr. Basford: So long as it is recognized that this would not affect in any way the right of a judge to order otherwise.

The Chairman: No, no.

Hon. Mr. Basford: I think there is some confusion with respect to the American procedure, which I suspect this has been copied from. The procedure here is quite different. If something is going to be left out, if the shareholder's proposal is going to be left out under rule 14(a) of the Securities and Exchange Act, I am advised that then management has to file with the SEC counsel's opinion as to why they are leaving it out and the SEC is entitled to review this and make a decision. So the procedure here is really quite different and this has been taken from it, I think, without appreciating what the American procedure is.

The Chairman: No, I would not say that, because you do have a procedure here where, if the shareholders are not satisfied, or if the minister is not satisfied, you can go to the court to get an order.

Senator Molson: This is dealing only, though, with the publication of the proposal. It does not in any way affect the shareholder's right at the meeting when he is in order to bring up a point for suggestion at the annual meeting. It is merely the notice.

The Chairman: Yes.

Hon. Mr. Basford: I am not pressing my point, Mr. Chairman. I did want to say, however, that it does not affect the right of a judge to make an order.

The Chairman: It does not, subject to section 106I. That amendment carries.

Hon. Senators: Agreed.

The Chairman: Now, Mr. Minister, if you would look with me at section 106I, at the top of page 40, I have difficulty in trying to appreciate what is intended by the words at the end of that sentence. This is where you apply to the judge and he makes an order that the company really, in effect, include in its information circular the proposal put forward by the shareholder. But I do not know the additional power you are giving to the judge by the words at the end of that sentence, "such other order as to the judge seems fit." That looks like carte blanche to the judge to apply any order of any kind. I do not know what it is. I do not know what would arise. I am wondering what the purpose of its being put in there is.

Hon. Mr. Basford: Surely for the judge to have the power that he would think he would require to ensure the shareholder's right. I am not sure that I can conceive of the kind of orders that would be made. A hypothetical case would be if the circular notice of meeting had already gone out and a judge were of the view that management had acted in quite a wrong manner; in that case the judge could make an order that the proposal be circulated.

The Chairman: He has that power. He can make an order on the application. The judge designated may make an order of compliance requiring such person designated to comply therewith. That is the person in respect of which the application is made. In other words, he would issue an order of compliance. I am wondering what more authority you are going to give him.

Hon. Mr. Basford: To comply therewith refers to sending out the proposal in the ordinary mailing of the notice of the meeting, which may, by the time this gets in front of a judge, already have gone out. The judge may, in order to protect the shareholder's right, if management has acted in quite an improper way and the notice of the meeting has already gone out, order management to send the proposal out. I am speaking of very hypothetical cases, but that is one that comes to mind.

Senator Phillips (Rigaud): He might even order an adjournment of the meeting, Mr. Chairman, pending the consideration of the motion of the minister.

The Chairman: But it is the indefinite character of the wording that I am objecting to, senator. I can see that if the notice, or if the information circular, has already gone out, then to make an effective order of compliance the judge would have to either order the adjournment of the meeting or, if there were still time enough to get it out, order that this information circular be revised and be mailed within a specific period of time. I can see those things. But what else? I always wonder when I find words as broad as these just what horse is going to ride through them some time. I want to know what the draftsman has in mind.

Hon. Mr. Basford: Well, Mr. Ryan is the draftsman. He can speak for himself. But I have faith in the judge to make a proper order.

Mr. Ryan: The draftsman also has faith in the judge to do that.

Senator Phillips (Rigaud): I, too, have faith in judges, depending upon their conclusions.

The Chairman: When they give a judgment in your favour they are wise and upright judges.

Senator Flynn: Sometimes even when I lose I think that the judge has found the fault.

Mr. Ryan: Typically with a provision of this kind, Mr. Chairman, no group of draftsmen or any single draftsman, trying to look forward to the future, can anticipate all the possibilities that may come up before a judge in a given set of facts of this kind. One can see the necessity for an adjournment, perhaps the necessity of having the whole matter done over again and perhaps the necessity of dealing with the matter of costs and other things as well. It is impossible to conceive of everything. Therefore, you are in a situation where, if you start listing those things that you can see, you may have made the very first case that appears incapable of being dealt with satisfactorily by the judge.

The Chairman: Mr. Ryan, I have a suggestion to you right on that point. Suppose instead of the words "for such other order" you said "and for such additional order in connection therewith as may be necessary to implement the order of compliance".

Senator Phillips (Rigaud): I was about to suggest the very thing, Mr. Chairman: "and for such other order related to such compliance".

Mr. Ryan: Of course, you will restrict the meaning. If compliance is not capable of being ordered at that time, is there any other

situation that the judge might make a cure of?

The Chairman: He has no other jurisdiction.

Hon. Mr. Basford: The compliance is the inclusion of a shareholder proposal in the normal regular mailing to the shareholder. That is what compliance refers to, and that may already have happened. If you give some wording to the effect of ensuring or getting compliance, it does not answer the problem that the opportunity to comply may already have passed. I think that is what Mr. Ryan is getting at.

The Chairman: No, it has not passed.

Hon. Mr. Basford: Yes, because the ordinary mailing has already gone out.

The Chairman: But he can adjourn the meeting.

Hon. Mr. Basford: The point the draftsman is making is that compliance does not refer to such things as adjournment, because the compliance refers to the inclusion of the proposal in the ordinary mailing of a notice of meeting.

The Chairman: But the words that we were suggesting, Mr. Minister, were: "for such additional order as may be necessary to implement the order of compliance".

Senator Flynn: Mr. Chairman, I would suggest these words: "for such other related order as to the judge seems fit".

The Chairman: "Seems necessary".

Senator Flynn: "Related order": that is the point.

Senator Aird: I must agree with Senator Flynn, Mr. Chairman. I think what you should establish here is a relationship.

Senator Flynn: Yes. Such other related order.

Hon. Mr. Basford: I have no objection to Senator Flynn's wording, Mr. Chairman. It is when it refers back to the compliance itself that I have difficulty.

The Chairman: Perhaps "such other relevant" would be better.

Senator Connolly (Ottawa West): "Relevant" is a better word.

The Chairman: A relevant order, yes. Are you satisfied with that, Senator Phillips (Rigaud)?

Senator Phillips (Rigaud): Yes, Mr. Chairman.

Hon. Senators: Agreed.

The Chairman: We assume the minister is ready to accept that.

Hon. Mr. Basford: Yes.

Senator Molson: So you are just inserting the word "relevant"?

The Chairman: Yes. Is it agreed that we insert the word "relevant" in the last line of that section 10I., between the words "other" and "order"?

Hon. Senators: Agreed.

Senator Connolly (Ottawa West): Mr. Chairman, on a subsidiary matter, I notice it happens often in legislation that corrective action can be taken by the chief justice, the acting chief justice or a judge designated by them. The fact is they always designate. I am not suggesting an amendment at this time, but would it not be a good idea if instead of doing it that way we were to put it as a judge in the superior court of the appropriate jurisdiction?

Hon. Mr. Basford: I have asked exactly the same question, Senator Connolly. The answer I get is that this is the way it has been worded in the Companies Act for quite some time, the purpose being that the chief justice generally designates one judge on his bench who has some knowledge and expertise on company affairs. That is why it is there.

Senator Flynn: There may also be the question of avoiding shopping to every judge successively.

Senator Connolly (Ottawa West): Those may be good reasons. All right.

The Chairman: The next amendment I want you to look at is on page 42. The suggestion is to strike out lines 21 to 25, inclusive. Really the only thing new here is to require that the applicant shall present his application in solemn declaration form. It would then read:

> "(2) Where it is shown to the Commission by the Minister or upon the solemn declaration of the applicant shareholders

that there are reasonable grounds for believing that in respect of the company concerned,"

And then all the other parts flow on from there. This is a serious step that a percentage of the shareholders take, and it should be impressed upon them. It is so easy to write a letter, but if you have to affirm it, it is another matter.

Senator Flynn: It is a question of form only of the application by the shareholders.

The Chairman: Yes, that is right.

Senator Aird: Do I understand, Mr. Chairman, that a solemn declaration equates to a declaration under oath?

Mr. Hopkins: Mr. Ryan suggested this form of words as covering the situation. However, Mr. Ryan can speak for himself.

Mr. Ryan: "Solemn declaration" is the terminology in the Criminal Code and that is why it is in this form here.

Senator Connolly (Ottawa West): Mr. Chairman, just on that section I have a note here—"112.(2) (b)...in a manner unfairly prejudicial to the interests of any shareholder;" and I have the word "wrongfully".

The Chairman: We are going to come back to that, Senator Connolly. I am taking it in a certain order where we have at least had language approval with Mr. Ryan. We will be coming back again to the first part of 112.

Senator Martin: I should point out that in the language of the bill the minister follows the applicant shareholders and in the amendment the minister precedes the applicant shareholders.

The Chairman: I think that is the order in which it should be. While we are on the point, and I do not want to embarrass the minister, I feel it is just not the right language to use to say that the Minister may apply to the Restrictive Trade Practices Commission himself. I think that where the minister is concerned asking him to apply to an administrative body is not the language that should be used. I think we should word it that he refers it to the body.

Hon. Mr. Basford: I am in the hands of the draftsmen there, Mr. Chairman.

Mr. Ryan: In that particular language where it is shown to the Commission by the minister it is not an application by the minister.

The Chairman: I am talking about paragraph (1). There it says "...the minister on his own initiative, may apply to the Restrictive Trade Practices Commission". I think it should be that he may refer an application to them. We have had so much debate, and the Government Leader is well aware of this, because he was the one that provided the spark in a resolution in the Senate during the last session that we are very sensitive about the areas in which administrative bodies operate. We are very concerned that the minister should not be in any sense in the hands of administrative bodies. Therefore he would refer things to an administrative body and not apply to it for anything. Would you like to defend your language, Mr. Ryan?

Mr. Ryan: I do not think you have left me with any defence.

The Chairman: Then we shall say that the minister "may refer" instead of "apply" to the Restrictive Trade Practices Commission any such application.

Hon. Mr. Basford: Could I ask what happens then? Having referred it, what does the commission do?

The Chairman: The commission goes ahead.

Senator Flynn: It would decide on it in the same way as it would have if you applied.

Senator Martin: You may not decide to refer, but if you do, you do so as a Minister with a higher authority than the board to which you are called upon in this section to refer it.

The Chairman: We know the point we want to deal with here, so supposing we stand it and let Mr. Ryan and Mr. Hopkins settle the exact language. We approve in principle.

Hon. Mr. Basford: I find it very amusing because I have been attacked in all the financial press of the country and by some senators for wanting to control too much in a personal way the investigative process, and that is why we have the Restrictive Trade Practices Commission.

Senator Flynn: We want the lesser of two evils.

Hon. Mr. Basford: I see. Your show of confidence is inspiring, senator.

The Chairman: We will not indulge in names, but I was not aware that any senators had attacked you on that ground. We will be coming back to 112 on another point.

The next amendment is on page 43. Senator Molson and Senator Flynn made a contribution to the discussion last day concerning the use of the words "fraud, misfeasance or misconduct". Now as to language the agreement is that if an amendment is to be made we should use "fraud, misfeasance or other misconduct," which would then bring the *ejusdem generis* rule into play. Then it would be misconduct of the character of fraud or misfeasance.

Senator Everett: Mr. Chairman, I would like to ask Mr. Ryan why he uses the term "misfeasance" and not "malfeasance." I ask you that because I think those two words have definite legal connotations and are definable in law. I would think that fraud would be better joined with malfeasance than with misfeasance.

Mr. Ryan: May I just read you one comment from a dictionary.

> Misfeasance (in law) trespass, a wrong done. In more modern use more specifically the misuse of power, wrong behaviour in office, a wrongful and injurious exercise of lawful authority as distinguished from malfeasance and non-feasance.

Senator Everett: I think malfeasance requires some sort of prejudicial thought in advance thereof and it seems to me to tie in better if you are using the *ejusdem generis* rule with fraud than misfeasance.

The Chairman: Except if you add "or other misconduct" you cover the element of malfeasance.

Senator Connolly (Ottawa West): To cover every criminal aspect.

The Chairman: Yes, that is right.

Mr. Ryan: I would think that all the rest of it would be caught up with "misconduct".

The Chairman: That is what I said. Any comment, Mr. Minister?

Hon. Mr. Basford: None, Mr. Chairman.

Senator Flynn: I would like to know what would be the French text in such a case, because I do not like the idea of "autre faute de gestion". It seemed to me that it was very broad.

Mr. Roger Tasse, Assistant Deputy Minister (Corporate Affairs), Department of Consumer and Corporate Affairs: Mr. Chairman, we could not think of better French wording to translate "fraud, misfeasance or misconduct."

Senator Flynn: "Faute de gestion". . .

Senator Connolly (Ottawa West): That is not "misconduct"; it is "mismanagement", perhaps.

Senator Flynn: "Error of judgment".

Hon. Mr. Basford: But it is qualified in the French—and I am no expert on French—by the "autre". However, I am not arguing the French with you.

Senator Flynn: But "misconduct" and "faute de gestion", to me, are so far apart that the word "other" would not have the same connotation.

Senator Connolly (Ottawa West): If you use "faute de gestion" you may be getting outside the criminal law. Unless the other argument about subsidiary powers can be invoked successfully, you may very well be legislating beyond your jurisdiction.

Senator Molson: Faute de conduite.

Senator Flynn: J'aimerais mieux si l'on pouvait dire inconduite.

Mr. Tasse: Est-ce que l'on n'aurait pas le même genre de problème avec le mot "inconduite"? Je pense que, disons, à la fin des deux textes. . .

The words in the two versions are equally good and ought to be integrated in the context of the two sections, unless there is a contrary intention.

Senator Flynn: But using the very wide expression of "faute de gestion" would have the effect of diluting the meaning of "misconduct" in the English.

Senator Connolly (Ottawa West): Surely, it would broaden it.

Senator Flynn: Yes, that is what I mean, it would broaden it.

Senator Connolly (Ottawa West): The net would be bigger.

Senator Flynn: Yes. If you could find a word close to "inconduite"—and we will leave

it to you, but I think it would be closer to the exact translation of "misconduct" and would be better than using the words "faute de gestion".

Mr. Tasse: The word that comes to mind is "mauvaise conduite", which is very broad too.

Senator Flynn: "Autre conduite fautive"?

Senator Martin: Mauvaise conduite, c'est la même chose que "misconduct".

Mr. Tasse: At least, one nice thing about the words we have in the French text is it has to do with the affairs of the company.

Senator Gelinas: Do you not think it is strong enough, Senator Flynn?

Senator Flynn: I think it is too wide.

Senator Connolly (Ottawa West): The plain fact of the matter is this, that if the charge were laid in French against a French person, he would say, "Charge me under the English section!"

Senator Flynn: Maybe we could find a solution by adding "ou autre faute de gestion de même nature"—of the same nature as fraud and "abus de pouvoir".

Senator Connolly (Ottawa West): And you keep the criminal aspect?

Senator Flynn: "autre faute de gestion de même nature".

Senator Connolly (Ottawa West): There is the *ejusdem generis* rule again.

The Chairman: Mr. Tasse, are you taking note?

Mr. Tasse: Yes.

The Chairman: Are you agreeable?

Hon. Senators: Agreed.

The Chairman: Is it agreed that the French version is changed by adding after the word "gestion" the words "de même nature"?

Hon. Senators: Agreed.

Hon. Mr. Basford: Could I just say, Mr. Chairman, that I have no observation to make on the amendment the committee has made to the French translation. However, this is subject to whatever comment the Department of Justice translators may wish to make. Mr. Ryan does not purport to be one of the experts in French, nor does the minister.

The Chairman: Are you ready to speak on this now, Mr. Ryan?

Hon. Mr. Basford: No, no. I say, "subject to whatever comments they may have to make".

The Chairman: We have proceeded with the amendment and if there is a serious presentation...

Hon. Mr. Basford: The sponsor could deal with this in the Senate.

The Chairman: Yes, we can deal with it on third reading.

The next is on page 43. The proposal is to strike out lines 18 to 25, both inclusive—and you have a copy there. May I give you the background? Under section 122—the new clause 12 of the bill—dealing with investigations, there were two questions which I raised. One was that at the stage of the determination by the commission as to whether an inspector should be appointed, the persons against whom the allegations are made should have the opportunity to be present and to be heard, to see the allegations and supporting material and to cross-examine those who make the allegations.

Then, when I put that forward the other day, I asked the minister what objection he had to it. The objection he put forward was this, that is some cases, if they gave such notice and the order to appoint an inspector was subsequently made, and they came to seize the books, the books might have been destroyed. So what I suggested to deal with that was that we give the commission, at the stage it receives the application, the right, in its discretion, to impound the books and records at once.

We have a draft of that which comes later, because the order we are following is an order in which there was more or less agreement on language, and we are dealing with them first. But what we are dealing with now, on page 43, is the second part of this point I made. This is the part which entitles the people who are complained against to appear and be heard, to see the material and to have the opportunity to cross-examine those who have made the allegations. You have a copy before you and, Mr. Minister, I think you have a copy, have you not?

Hon. Mr. Basford: Yes.

Senator Molson: Just adding "company" to "the minister".

The Chairman: Here is what it says:

Strike out lines 18 to 25, both inclusive, and substitute therefor the following:

"(4) Where an application is made under subsection (1) by shareholders, the applicant shareholders shall give the Minister and the company reasonable notice thereof and the Minister and the company or their authorized representatives are entitled to appear in person or by counsel to examine the application and supporting material, to cross-examenine the applicants, and to be heard at any hearing of the application."

Do you have any comment, Mr. Minister?

Hon. Mr. Basford: Yes, Mr. Chairman, may I comment with some enthusiasm in expressing my personal opposition to this amendment, with respect?

The purpose of this whole investigation procedure is to assure the incorporating agency—which in this case is the Federal Government—the power to examine the affairs of its creatures or children. We incorporate companies which go out with a federal name and a federal charter, and it seems to us, in our obligations to the public and to the investors and creditors, that we should have the right to investigate those creatures of ours.

We have had in the act for quite some years, since 1934, an investigation procedure. These amendments are designed to improve that procedure; with, at the same time, building in proper safeguards against harassment, malicious and frivolous inspections and investigations. This is why we have the Restrictive Trade Practices Commission.

I think that senators should be aware that most of the cases that would be examined and inspected under these sections concern some pretty unscrupulous and undesirable operators.

The Chairman: They might be.

Hon. Mr. Basford: Well, if they are not the commission probably would not find reasons for investigation. But, there are safeguards. The commission is left with the decision of whether notice shall be given or not. Throughout the whole inspection procedure counsel is allowed, and cross-examination is allowed. Before a report is made, and before the commission agrees with a report, any person against whom the report is adverse must be given a copy, must be allowed to examine that report and to cross-examine on that report. So, it seems to me that there are sufficient safeguards provided in this section.

The Chairman: Will you stop at that point, please. This is exactly what you said on the last day when I put the question to you, and when I asked you to divide your consideration. I did not want answers as to what the protections are, or as to what the safeguards are, after an inspector has been appointed. I asked you to assume that they are adequate. I want you to address yourself to the point where an application is made, and before a decision to appoint an inspector is made. Tell me what are the safeguards there. This is designed to provide safeguards at that level, before the order appointing an inspector is made. Your telling me that the sections of the bill provide ample safeguards and protection after an inspection is made is simply avoiding the issue.

Hon. Mr. Basford: With respect, Mr. Chairman and senators, I was not trying to avoid your question. There are senators here who were not present two weeks ago, and I wanted to place my arguments in front of them. I think that this additional provision is unnecessary by reason of the fact that there are other safeguards in the bill. I would point out, Mr. Chairman, that is extremely unusual, if not unheard of, that in an investigation procedure involving allegations, or possible allegations, of fraud and extreme misconduct that the person against whom those allegations are made be given notice before anything is done. It would mean, Mr. Chairman, if this amendment were accepted, that shareholders of a federal company, which we had incorporated, could come to the commission with allegations of fraud, and that the persons against whom the allegations were made would have to be given notice of that fact, while the same shareholders alleging fraud could go to a provincial attorney general and not have to give that notice. The police in investigating criminal allegations or allegations of fraud do not give notice. That is well known. When a police authority carries on an investigation it does not tell the people who are being investigated.

So here the commission, under this act, investigating a federal creature, a federal company, would have to give notice to those against whom fraud was alleged, while a provincial attorney general would not. That seems to me to be quite an inconsistent situation.

I also suggest...

The Chairman: Would you stop right at that point. Let us deal with your points *seriatim*. You are comparing two situations that cannot be compared. If the administrative procedures are as adequate as you would indicate for the investigation of crime then that is in the hands of the provincial authorities, and they have their own method of conducting their proceedings. What I am saying here is that this is not the same sort of situation. Here a percentage of shareholders will make an application alleging that somebody in management has been guilty of fraud. Now, at that stage the persons against whom the allegations are made, and before an inspector is appointed, should have the opportunity of putting forward their side of the case, they should not be labelled, because at the decision to appoint an inspector there is no hearing in the sense that there is one afterwards. It is simply a matter of their considering the application, and making an order appointing an inspector. The inspector then goes to work and holds a public hearing, but this is after the allegations are made.

Hon. Mr. Basford: Excuse me, but it is not a public hearing, Mr. Chairman. The inspection and the inquiry are conducted in private, and the Restrictive Trade Practices Commission—which I know is a body you do not always envy—has at least a record of maintaining the secrecy of its inquiries and inspections. Nothing becomes public under this inquiry procedure until such time as the whole inquiry procedure is completed, and until those against whom any allegations are made have had an opportunity of seeing those allegations, cross-examining on them, and challenging them, and then it only becomes public when the commission decides that it becomes public. I would point out that it also has the right to decide that the proceedings shall never become public.

Senator Connolly (Ottawa West): I accept what the minister says on the matter of the public hearing, but I think the chairman has a point here, Mr. Minister, in that you can have a frivolous complaint laid by five or more shareholders, and it might very well save a great deal of time of the commission, if the complaint being made against the company, or some of its officers or directors, is frivolous, if they do not have to embark upon the investigation. What the chairman is, in effect, saying to you, as I understand his remarks, is this, that you should give the group against whom a complaint is laid an opportunity to defend itself forthwith, and you might very well avoid an investigation. I think there is an element of fairness in it anyway, and it might very well cut out frivolous complaints.

Hon. Mr. Basford: Senator Connolly, I might say, with respect, that I am as concerned about frivolous complaints as anyone else, but there are several techniques in the bill which guard against frivolity. First, there are reasons spelled out on the basis of which the investigation can be launched. Now this morning I accepted an amendment to the effect that it must by by solemn declaration. People are not going to sign solemn declarations frivolously.

In the House of Commons I accepted willingly an amendment put forward by Mr. Marcel Lambert relating to costs, under which the commission can make an order as to costs, which again is a guard against frivolity.

So, I submit that the section as put in, and as amended in both the other place and here, contains safeguards against people acting recklessly and frivolously. You know, there are safeguards...

The Chairman: I do not think it has, Mr. Minister.

Hon. Mr. Basford: Perhaps I could make just one other point, Mr. Chairman, which I think is a rather important point. I do rely upon the fact that notice, in certain instances could result in evidence being destroyed or manipulated before it is got hold of. As you have pointed out, Mr. Chairman, you have an amendment to deal with that later on, which I am going to have to oppose, but this really goes together as a package. People will have notice that an investigation is to be launched, and the commission before it decides that an investigation shall be held will make an order to seize and search books. It seems to be a rather peculiar situation that the commission should make an order of search and seizure before it decides whether to hold an inspection or not. Surely, that is an anomalous situation, but that is what these two amendments taken together would provide. Under the two amendments the five shareholders would apply to the commission, and the commission would say: "We have this application. We have to give notice to the persons complained against, but in order to decide whether an investigation should be held and

to protect the evidence we have to make an order for search and seizure". So, before it decides on the appointment of an inspector, and before it decides upon the holding of an inquiry, it has to have an order out against some company, or a group of directors, for search and seizure. Now, if one wants to damage a group of directors then it seems to me that there is no quicker way of doing it than that.

Senator Cook: I was going to say, Mr. Chairman, that it seems to me that first of all you must have five shareholders, and secondly they must represent 10 per cent of the capital. Then go before the Restrictive Trade Practices Commission, which we assume would exercise some judicial discretion, and at that point, having carried out the process of subsection (2), the commission may or may not issue an order.

What we are trying to prevent, on the one hand are frivolous investigations, and I agree with that. However, on the other hand, in my opinion we also want to stop giving notice to fraudulent financial businesses. I can think of some pretty smart financial people in the area I come from who, if they knew of an investigation, would get hold of the books before the commission. I think the dangers of frivolous investigations are much less than the dangers of giving notice to fraudulent financial businesses. I agree with the provisions of the act now.

The Chairman: Senator Cook, the thing you are overlooking completely is that first of all it is only when the shareholders make an application that these provisions would apply. If the minister refers the matter, these provisions do not apply under the amendment as proposed. The second thing is that when five shareholders join, representing a tenth of the issued shares in an application to the commission, they have to make allegations, for instance, that the manager has been guilty of fraud. After that stage we say that is the point—and there is no publicity—where the manager, against whom the allegations are made, should have the opportunity of meeting it.

Now, as to the question that they might get at the documents, I explained to the committee that there is anoher subsection providing for the commission to impound the documents at that time so that there cannot be destruction of them.

Senator Cook: There can be transfer of personnel, however.

Senator Flynn: They cannot do that as soon as they hear that an application has been made to the minister. They can hear about it just the same, even if no notice is given.

Senator Phillips (Rigaud): You have suspended for consideration one point on page 42 which you said you would come back to. This is in regard to the possible insertion of the word "wrongfully" which we discussed at one of our previous hearings and to which Senator Connolly (Ottawa West) referred to a few moments ago. I think that some of us, at least before judgment is issued on the basic issue here, would like to know what the views of the committee will be with respect to the insertion of the word "wrongfully".

You will remember a few weeks ago that I made the point. Senator Connolly can refer to his notes there in regard to that word. I have forgotten whether I gave the exact example, but five shareholders may take a point of view that the dividend policy of the company is prejudicial to them or that the acquisition or disposition of certain assets may be prejudicial to them, or that sort of thing, and that the wording in subsection (b) is of an essentially civil nature.

I suggest we might entertain the thought of using the word "wrongfully". If we were to introduce such a word "have been wrongfully performed" and having already agreed to the amendment "or other misconduct," with the appropriate French version, at least the senators will be in a position to come to some conclusion as to whether the insertion of the word "wrongfully" may or may not deal with the problem up to a point. With the elimination of the word "wrongfully" I think we have reduced paragraph (b) to civil conduct.

The Chairman: I was wondering where you suggest putting the word "wrongfully"?

Senator Phillips (Rigaud): In paragraph (b).

Senator Urquhart: Line 33 before performed. That is what was suggested last week.

Senator Phillips (Rigaud): "Have been performed wrongfully".

The Chairman: "In a manner unfairly prejudicial".

Senator Phillips (Rigaud): Yes. I thought if we have that word in and if the minister

could see fit to agree to the insertion of it, that it might bring about a qualified reaction to the subject matter.

The Chairman: Do you have any comments on that, Mr. Basford?

Hon. Mr. Basford: Where are you suggesting the word "wrongfully" should go? "Performed in a manner wrongfully prejudicial"?

The Chairman: No, "performed wrongfully in a manner".

Senator Phillips (Rigaud): It is consistent with the insertion of the other misconduct and generous rule. We should have the whole concept of fraud or other misconduct and irregularity and so forth, which I think has a bearing upon our chairman's thinking by emphasizing the quasi criminal aspect.

I was going to suggest, Mr. Chairman, if the minister would see fit to do so and you on your account would see fit to consider as to whether the proposed amendments should be considered . . .

Hon. Mr. Basford: I really have no objection except that it has been pointed out to me that if we put "wrongfully" in after performed, that the "unfairly" should come out. It should be "performed wrongfully in a manner prejudicial to the interests . . .", because surely the unfairly is contained within the wrongfully.

Senator Connolly (Ottawa West): I do not think the department should care, because once you reinforce the criminal jurisdiction, the criminal aspect of the thing, then you are clearly helping yourself on jurisdiction.

Hon. Mr. Basford: We have no problem with jurisdiction.

Senator Phillips (Rigaud): I am relating the insertion to the subject matter that is now being discussed.

Senator Flynn: One way or the other it would be a good amendment.

Hon. Mr. Basford: I see no difficulty in putting "wrongfully" after "performed," but if we do that it seems to me that "unfairly" should come out.

The Chairman: Is that agreed?

Hon. Senators: Agreed.

The Chairman: So we shall amend subsection (2) of new section 112 on page 42, subparagraph (b), by striking out the word "unfairly" in the thirty-third and thirty-fourth lines and inserting "wrongfully" in the thirty-third line after the word "performed". Is that approved by the committee?

Hon. Senators: Agreed.

Senator Phillips (Rigaud): In the light of that fact, would you reconsider the desirability of pressing for the attendance of the parties against whom the complaint is made?

The Chairman: It does not change my viewpoint on the position of where the commission has received an application and the rights of the person against whom these allegations are made. As a matter of fact, putting in the word "wrongfully" only increases it because it gives it completely the character of a criminal allegation. I think there should be the opportunity for people to be heard. There is no publicity about it.

Senator Flynn: Mr. Chairman, the minister has not gone further than to say that your amendment is unnecessary. I don't think he has convinced us entirely that it would be dangerous, because as you say there are other safeguards that could be inserted in the act.

I would like to come back to paragraph 1 of section 112 and to note that the commission would have the right to give notice to such persons as the commission may require for an order. That is before the order is given. Therefore, the principle is already embodied there. I would say that the commission could give notice of the application to the company or to the persons affected by it.

Hon. Mr. Basford: That is right. It is provided that if the commission saw fit in proper circumstances to give such notice, but we are concerned about that, hopefully, minority of cases where we are dealing with the kinds of people Senator Cook dealt with in his remarks.

The Chairman: I am not sure you meant that.

Hon. Mr. Basford: I meant that he dealt with it in his remarks in this committee—where the commission would feel that notice should not be given—and it is to be hoped that that would be a minority of cases. It is probably those cases where the fraud and the misconduct occurs and where the investors and the creditors are being "taken to the cleaners".

Senator Flynn: Would it be possible to reach a compromise between your position and the chairman's position, by taking this off from section 112, the notice, and dealing with the question of prior notice in a separate section, saying that generally speaking, except where the commission fears that by giving notice it would give a chance to...

Senator Beaubien: To culprits to escape.

Senator Flynn: Yes, that the commission should always give the company or their authorized representative the right to question...

Mr. Hopkins: Etcetera.

Senator Flynn: We would put the principle there but we would give the right to the commission not do it if it saw fit, because of special circumstances. But we would affirm the principle.

Senator Cook: It would be ten times worse.

Senator Flynn: No. You could do it under subsection (1) of Article 112.

Senator Cook: But you are judging him before you hear him, then.

Senator Flynn: Then you say the commission should do it except if it appears that by doing this you would be giving a chance to get rid of some of the evidence, or otherwise. It would be up to the commission to assess the dangers which the minister has outlined, that you outlined, but the principle would be that generally speaking you give the chance to the company to cross-examine the applicants. The principle is already there in subection (1). But it is so hidden that it does not give a fair chance that you are seeking to give.

The Chairman: As I understand it, what you are suggesting is to have words something like this "except in a case where the commission feels that the giving of notice would imperil...

Senator Beaubien: Jeopardize the evidence.

Senator Flynn: Jeopardize.

The Chairman: Then these rights are to be enjoyed. The only discretion you are giving the commission is the discretion to decide whether it is a proper case.

Senator Flynn: Yes.

The Chairman: If they decide it...

Senator Flynn: They would have to think it over. They would have to be more careful.

The Chairman: We were attempting to deal with that by giving the commission the right to exercise its discretion as to whether, before it proceeds to hear the application, it would seize the books. It is along the same lines.

Senator Flynn: It would become a matter to decide in every case, except where the commission might feel that the issue would be jeopardized.

Senator Beaubien: Certainly, it is a good compromise.

Hon. Mr. Basford: I was looking for some wording. I do not know whether we can find it.

Senator Flynn: Probably it would require an amendment to section 112—subsection (1)?

Hon. Mr. Basford: Perhaps we could go on to something else?

The Chairman: Shall we let it stand?

Hon. Senators: Agreed.

Senator Molson: I would like to ask the minister something. Without something of this order suggested now—and I am not getting into the details of it—is it not possible today that if you have a fight for control, an individual that would have, say 10 per cent or better, could get two or three or three or four of his cousins, to get the five shareholders, for the sake of argument, and then request this investigation and it might be in this sense on frivolous ground because he is merely seeking to...

Senator Beaubien: Discredit the administration.

Senator Molson: Yes, and really seeking to get control of the thing. It would be almost impossible at that stage, without going into it in some depth, for the commission to make a decision as to whether it was frivolous. But immediately they could go into it, and hear perhaps the other side or some other side, the whole purpose might become apparent. Is this some reason? Is this not possible? Is there not a strong possibility where you might have a couple of bad fights where there seem to have been no holds barred.

Hon. Mr. Basford: It is partly for this reason, I suppose, that I cannot accept the two amendments that I suggested here, because

the power of search and seizure is such, as provided in these amendments, that in that case those five shareholders, wanting to gain control and wanting to embarrass management, could make up their frivolous complaint and the commission, as the amendment proposes, would have to order search and seizure.

The Chairman: No.

Hon. Mr. Basford: That is what it says, Mr. Chairman.

The Chairman: No.

Hon. Mr. Basford: If it wanted to.

Senator Flynn: We could put that at the option of the commission, as in the suggestion that I have made. Here the commission "may order".

The Chairman: No, Mr. Minister, you are wrong. The proposed amendment on seizure says "may", that is, that the commission may, immediately on receipt of the application, and prior to issuing its order for the investigation, by ex parte order...

Hon. Mr. Basford: And if the five were able to persuade the commission that this is what they should do, that there was danger of these books disappearing or being tampered with, that management, by the fact, that the company's books had been seized—I do not suggest destroyed, but certainly been damaged in its fight, before the commission had even decided to hold an investigation.

With respect, my opposition to this is not frivolous. It is for those reasons, with respect, that I would urge senators not to accept those amendments.

The Chairman: I think the amendments are in the interests of the people against whom the allegations are being made, at a stage where positive action will be taken and they would have no notice. You want protection and I asked you the reason for it the other day and you said that they might destroy the documents and I said we would give you an amendment to impound them right away. They still have right of proceeding.

Hon. Mr. Basford: With respect, I say that is a very unusual procedure which I have real doubts that the House of Commons would accept, because you could have search and seizure of the company's books before you have any decision to have inspection.

The Chairman: That is not the judgment we make, on whether we amend or not, that the House of Commons may not accept it.

Senator Flynn: If you have that fear or if the commission has that fear, as soon as it will seize on application it will immediately issue the other order impounding the documents. It will be done at the same time and can be done in one day.

Hon. Mr. Basford: No, Senator Flynn.

Senator Flynn: There is no real protection or difference.

Hon. Mr. Basford: With respect, that is not the case.

Senator Everett: Under this amendment, under the proposed amendment, is it not so that the complaint is made, the commission makes an investigation, it determines whether or not to issue an order and when it issues an order, notice goes to the parties affected and they can appear at that time.

Senator Flynn: They can order seizure at that time also.

The Chairman: On the investigation, after the order appointing the inspector is made. That is what Bill C-4 says.

Senator Everett: That is right, but if the commission decides not to proceed after making its investigation, nothing has been printed. If it does decide to proceed, those alleged to have committed the offence are entitled to notice and to appear and to hear all the allegations against them and the evidence in the hearing of the commission itself. That is a settled practice of the Restrictive Trade Practices Commission in combines investigations or resale price maintenance investigations.

I do not quite see the prejudice to the company where the commission is doing nothing more than investigating a complaint as to whether or not it is a valid complaint. If they determine in their mind that it is a valid complaint, they then issue an order and at that stage the company that is alleged to have committed the offence has the right to appear and to hear the charge and hear the evidence against it.

The Chairman: Senator, what you are overlooking is the fact that if the commission proceeds to investigate whether or not it should make an order, there is still the question of how it should proceed. How does it

proceed? The minister is afraid that the news might leak out and that the books might be destroyed.

Senator Everett: I am afraid of that, too.

The Chairman: This must happen if they investigate.

Senator Everett: Let us assume somebody writes to the director to the effect that a combine exists or that there is a conspiracy of some sort and it is entirely frivolous. If at that stage the director were required to issue notice to the parties concerned that they had received this complaint, then I think the thing would be an issue before the director ever found out whether the complaint was frivolous. If it is not frivolous, then the director issues an order—and I may be wrong in my procedure there...

Hon. Mr. Basford: I think you are.

Senator Everett: But at that stage a determination is made and notice is given to the companies or to the individuals affected. That is all this section means to me. I can see how, if you put in the amendment to the section, you might create a very embarrassing situation for the company involved because shareholders could be frivolous and might very well cause notices to the issued and books to be seized where the director himself does not want to do that and where the minister does not want to do it. Nevertheless, if they decide that it is not frivolous, there is no question here that the company is not going to get notice if they decide to proceed. It is only that they do not get notice if they do not decide to proceed.

The Chairman: The commission may impound the documents right away. That is all it says. This is in their discretion. They have to exercise that discretion based upon the nature of the allegations that are made.

Hon. Mr. Basford: It is also in here that they are prepared to trust the commission whether to seize and search and break into buildings. Those are words that I have never even seen before. You are prepared to trust the discretion of the commission with that tremendously powerful power and yet you are not prepared to trust the commission in the exercise of its discretion as to whether or not to give notice.

Senator Flynn: That is what I am saying. We should give the discretion to the commission not to give notice. My suggestion would be to give discretion to the commission not to give prior notice in cases where it deems that it would not be safe to do so. You reverse the situation. Here it gives discretion to the commission to give notice. I would turn it around.

Senator Connolly (Ottawa West): In what way?

Senator Flynn: In this way: we would affirm the right to the persons involved in the application to question the application unless the commission would deem that, by giving notice and by giving this right to question the application right away before an order is given, it would jeopardize the case and would allow an opportunity for the destruction of the books. I think the principle would be correct. We are dealing here with a situation which is about the same as an interim injunction.

Senator Cook: Your amendment would not hamstring the Commission.

Senator Flynn: The judge will not give an injunction unless he hears the party. He may issue an injunction for only five days, as you know, without giving prior notice.

Senator Everett: He has that discretion, and you are giving the Commission a similar discretion.

Senator Flynn: It would not give the Commission discretion not to give notice but would affirm the principle that notice should be given unless the Commission deems it dangerous. That would meet your point, Mr. Chairman.

The Chairman: I understand this section, Mr. Tasse, is pretty much taken from the Bankruptcy Act, in the seizure provision. Is that correct?

Mr. Tasse: I think there is a provision along those lines in that act, yes, although I do not have the Bankruptcy Act with me.

The Chairman: We will have that here in a moment. That sort of provision works in connection with seizure in the Bankruptcy Act, and the language is very similar to this amendment.

Mr. Tasse: Except that in the case of bankruptcy we are dealing with a company that has already gone under and is already out of business.

Senator Molson: And which has already destroyed its records in some cases.

The Chairman: Honourable senators, I think we should stand these amendments in order to see if we can incorporate language along the lines Senator Flynn has suggested.

Senator Flynn: I think it would be a fair compromise, if acceptable to the minister.

The Chairman: Is that agreeable to the committee?

Hon. Senators: Agreed.

The Chairman: Then on page 52, immediately after line 14 add the following as subsection (2) of proposed section 112c:

> "(2) Nothing in section 112, 112B or this section compels the production by a solicitor of a document containing a privileged communication made by or to him in that capacity or authorizes the taking of possession of any document in his possession without the consent of his client or upon an order of a court."

Now, this is, as you know, the client's privilege, and it is the solicitor's duty to exercise it on behalf of the client. The solicitor must assert the privilege, but the client can relieve him from that obligation, or you can go to the court and get an order.

Senator Connolly (Ottawa West): The privilege is the privilege of the client and not of the solicitor.

The Chairman: It is the privilege of the client, yes.

Senator Flynn: But it is the duty of the solicitor.

The Chairman: It is the duty of the solicitor to assert it, yes.

Senator Molson: What does "in that capacity" mean here?

Senator Flynn: As solicitor.

Senator Cook: He must be retained by the client. He cannot be just a friend or an acquaintance. It is not sufficient to speak to the lawyer as a friend or as an acquaintance, but you must hire him as your solicitor.

The Chairman: That is right. Have you any comment, Mr. Minister?

Hon. Mr. Basford: No. I have no objection.

The Chairman: Is this amendment agreed to by the committee?

Hon. Senators: Agreed.

The Chairman: There was a question raised the other day in connection with the use of the word "criminal" on page 52, section 112c. There you will find the words "any criminal proceedings". If I might just explain the point; ordinarily when somebody appears in court and he is asked a question to which he objects on the grounds that the answer may incriminate him, if the judge decides the question should be answered, he gives a direction to the witness to answer the question but tells him that the answer will not be used against him in any proceedings other than a proceeding for perjury. The question then arises as to whether the protection that is afforded in this manner is only in relation to criminal proceedings or whether it also applies in civil proceedings. I am not at all satisfied that there would be a civil protection.

Senator Flynn: It does not exist in civil matters.

The Chairman: No.

Hon. Mr. Basford: Here again we are in the hands of the draftsmen, Mr. Chairman.

The Chairman: The neat question is whether in your opinion the use of the word "criminal" does take away or limit in any way any right the person required to answer might otherwise have.

Senator Benidickson: Before Mr. Ryan speaks, would he comment upon the comparable rights of a witness before a Congressional committee in the United States.

Mr. Ryan: Mr. Chairman, I suppose that is in relation to the fifth amendment. This gets somewhat into that area insofar as the criminal law is concerned. The position in the common law would be, as I recall it, that if you were asked questions as a witness the answers to which would tend to criminate or incriminate you, you had the right to object to answering such questions. Subsequently statute law has come along in a number of areas and has removed that common law right of refusing to answer and compels you to answer but they preface it by saying, and this is from recollection, that where a person objects to giving evidence because the giving of that evidence would tend to criminate him and but for this act he would not have to give the evidence, he is then protected from the consequences of the evidence insofar as it

may not be used against him in a criminal proceeding or a quasi-criminal proceeding.

Now, in the Evidence Acts of the provinces—and I have only had occasion to refer to one recently—it is expressed in that way, but it says that where a witness is compelled to give evidence by an act of the Parliament of Canada or an act of the legislature of a province, and he objects to giving evidence but is compelled by this act to do so, the evidence so given by him may not be used against him in any action for a contravention of an act of the legislature of the province.

Section 5(2) of the Canada Evidence Act has a similar provision related to protection but it is related to a prosecution under an act of the Parliament of Canada or a criminal prosecution. Now the effect of this section 112C is that instead of the person being required to object to giving this evidence, he does not have to object, but the evidence may not be receivable against him. So in effect it has brought section 5(2) of the Canada Evidence Act in without his claiming the benefit of it.

Senator Flynn: I think the chairman wanted some protection for the witness if he was sued in a civil court. I do not think we should give him that protection.

The Chairman: What I said was that I do not think it goes that far.

Senator Flynn: It should not go that far.

The Chairman: And I do not know how we could do it.

Senator Flynn: It would apply only to criminal proceedings.

The Chairman: I raised the question only because some senators raised it the last time.

Senator Flynn: To me there is no doubt that in a civil case the evidence that he has given could be used again.

Senator Urquhart: Mr. Chairman, if in a civil court he was asked the same questions as he has been previously asked knowing that he had given certain answers to those questions, would he then be liable for perjury if he gave different answers? That is the point that is being made.

The Chairman: If he did not answer in the same way, he would certainly be committing perjury.

Senator Urquhart: So if he does not answer in the same way, he really doesn't have protection.

Senator Flynn: He does not have protection in a civil case.

The Chairman: Now, coming to page 52, line 38 you will find that we propose to strike out the word "for" and substitute therefore the words "to the extent of". There was a discussion of this last day in committee.

Hon. Mr. Basford: I have no objection to that, Mr. Chairman, but could we have an explanation of what it does.

The Chairman: Well, you can take the advice of your own counsel.

Mr. Ryan: I was consulted as to the form, and I could not see any objection to the form, but like the minister I am not sure exactly what it does.

Mr. Hopkins: May I echo the sentiments of Mr. Ryan exactly.

Senator Connolly (Ottawa West): Surely they mean the same thing. It is a very unimportant amendment.

Senator Flynn: Could we not leave it to Mr. Ryan to use it or not as he sees fit?

The Chairman: Mr. Ryan will be the interpreter. You say, Mr. Ryan, that you see no substantial difference in the use of the word "for" and the use of the words "to the extent of".

Mr. Ryan: There is no substantial difference, Mr. Chairman. But there might be—and I think one has to try to find some kind of difference to justify the amendment—in the sense that "for" is a preposition that is a bit tighter than "to the extent of" which is a looser preposition. one might reason from that that one cannot be used for amounts less than that whereas if you use "for" you are fixed to the amount. I do not think that is a substantial change.

Senator Connolly (Ottawa West): Next time put in "to the extent of" and we will change it back to "for".

Senator Flynn: It would give the right to take action for less than the amount. Would you see any justification for giving that discretion to the Crown? Could somebody object to the section on the basis that he is not being sued for the full amount?

The Chairman: I am not sure.

Senator Connolly (Ottawa West): The Crown can always make a settlement.

The Chairman: Coming now to page 53—and this is the last one we will deal with before lunch—there the recommended amendment is to strike out lines 12 to 19 inclusive and substitute therefor the following:

> "(4) Upon the termination of the investigation, the Commission may order that any security given pursuant to subsection (3) be returned to the applicant but if the Commission holds that the application was vexatious or malicious it may"

Then it goes on to (a), (b) and (c).

Senator Cook: Does "it may, upon the recommendation of the Minister," go in?

The Chairman: No, that goes out. We are taking the minister out of this section. He has been terribly overworked in this bill so far.

Hon. Mr. Basford: The commission could only do this on my recommendation, and apparently people don't like me that much any more.

Senator Connolly (Ottawa West): It might save you a great deal of headaches in fact.

The Chairman: We are very solicitous today. Is this agreed to?

Hon. Senators: Agreed.

The Chairman: We shall go into a different series of amendments this afternoon. There is one very important one; that is the question of validity, provincial securities legislation and this bill, and how we resolve it; whether we can create and maintain two parallel lines without having conflict.

Senator Phillips (Rigaud): What is to be done with Senator Flynn's suggestion with respect to the other item? Is that to stand?

The Chairman: Yes. Those two proposed amendments stand, and Mr. Hopkins will attempt to put Senator Flynn's thoughts in words. If Mr. Ryan is so co-operative as to sit in with him and add his experience and knowledge, we would appreciate it; but we will go ahead in any event.

Senator Connolly (Ottawa West): Mr. Chairman, could I ask the minister a question before we break up? This is a more general question. Although I could not put my finger on the clause, this act will come into force on proclamation—is that so?

Hon. Mr. Basford: Yes.

Senator Connolly (Ottawa West): Could you give me the reference?

The Chairman: This is on page 106.

Senator Connolly (Ottawa West): Assuming that to be the case, is there any idea yet in the minds of the officials as to when the act might be proclaimed?

Secondly, because this question has arisen and a number of people have been asking about it, for companies who have their annual statements due after the proclamation, will they be required to make special disclosure and file statements before the end of their normal fiscal year?

Hon. Mr. Basford: The section is on page 106, the last section, by which the act or any part of it could be proclaimed. I would think parts of it we would want to proclaim quite quickly, such as 38(a) which is very urgently needed. With regard to other parts, let us take the insider trading provisions. We have to set up the proper machinery within the department before we can proclaim it and make it effective, so I cannot give you a definitive answer; it will be spread out.

I think you were concerned about companies having to make two statements within one year. I think that is provided for within the act, that these provisions come in for its financial year.

Senator Connolly (Ottawa West): That is what I understood.

Hon. Mr. Basford: And they do not have to report on one basis for half a year and on another basis for the other half. It is geared to their financial year.

The Chairman: I just want to ask Mr. Ryan if he will have a look at one thing during the recess. I notice on page 79 you exclude the application of certain sections in the Corporations Act, and you provide for the substitution of a new subsection (1) in section 149. I was wondering if you would have a look at section 150 and tell me why it should not be excluded. Maybe you can tell us after lunch.

Hon. Mr. Basford: In answer to Senator Phillips' question, could I put on the record this, which senators may want to think about

over lunch. To me it would be a compromise relating to the investigation section, and an amendment on page 42 by which we would delete lines 15, 16 and 17 and replace them with the words:

> ...called the "Commission") upon reasonable notice to the company except where the Commission is of the opinion that the giving of notice to the company in view of the allegations made by the applicants would likely prejudice any investigation ordered by the Commission, for an order.

The Chairman: "give notice" I assume all the implications go with the giving of notice. On any hearing they may appear. Is that intended to be included? The giving of notice means nothing unless they are entitled to appear.

Senator Flynn: You could probably supplement that by saying, "When notice has been given".

Hon. Mr. Basford: It is notice of the application.

Senator Flynn: "When notice has been given as provided, then the company or the authorized representative may question..." and so on and so forth.

The Chairman: We will adjourn until 2 o'clock. I have mentioned one important point; that is the validity question. There is another question that was discussed at length the last day, the position put forward by Bell Canada as to whether they should be Letters Patent or not.

The committee adjourned until 2 p.m.

...Upon resuming at 2.05 p.m.

The Chairman: We are waiting for Senator Flynn, and while we do so I think that there are one or two items that we can clear up very quickly.

Mr. Minister, Senator Molson raised a question last week as to some of the offences created which are in their nature absolute and for which there is no defence. If a messenger on his way to the mailbox dropped some of the information circulars and proxies, and they did not...

Senator Beaubien: To say nothing of the Postmaster General.

The Chairman: The obligation is to send them by prepaid mail, so the responsibility is the responsibility of the company until such time as they are dropped in the box.

Senator Beaubien: If you can prove that they had dropped into the box.

The Chairman: You can always swear an affidavit as to that. Senator Molson raised the point that in these circumstances some person who might through some inadvertence or an act of God have this happen to him would still end us with a criminal record. I am told that there are five places in the bill where there are provisions under which this sort of situation could occur, and where there is no defence. It has been suggested, for instance, that on page 19, line 16, we insert the word "wilfully" after the word "who".

Mr. Ryan, you do assure us, do you not, that these are all the places where that sort of offence is created?

Mr. Ryan: Mr. Chairman, I could not give you that assurance. These are the ones that look as though they might create a question of absolute criminal liability. With respect to the others there are defences a little later on, but these are the dangerous ones.

The Chairman: My question was too broad. The five that are noted here create offences where there would be an absolute...

Mr. Ryan: Yes, it could be so interpreted by the court. The law is a bit of a jungle in this area.

The Chairman: So, on page 19, line 16, it is suggested that after the word "who" we insert the word "wilfully". I take it that you have no comment on this, Mr. Minister?

Hon. Mr. Basford: No, I have not, Mr. Chairman.

The Chairman: Is that agreed to?

Hon. Senators: Agreed.

The Chairman: Then, on page 31, line 20, it is suggested that after the word "who" we should insert the word "knowingly".

Mr. Hopkins: What about "wilfully"?

Mr. Ryan: Yes, "wilfully".

The Chairman: Very well, it seems that we should insert the word "wilfully". Is that agreed?

Mr. Ryan: Mr. Chairman, it really does not make that much difference, as long as there is

some adverb in there. I think "knowingly" is in your amendment.

The Chairman: Very well, we will make it "wilfully". Then on page 50, line 20, it is suggested that we strike out the word "knowingly", and put in the word "wilfully".

Mr. Hopkins: Well, there is doubt about that.

The Chairman: I am bowing to Mr. Ryan. He leans to the word "wilfully", so we are putting it in and striking out the word "knowingly".

Mr. Hopkins: But not in the next two.

The Chairman: This is only on page 50, line 20.

Mr. Ryan: May I explain that? It is more compatible with the "wilfully" that is already in the bill in other areas. That is the basic reason for the change.

The Chairman: We knew you had good reasons for it, Mr. Ryan.

Then, on page 77, line 12, it is suggested that after the word "who" we insert the word "knowingly". Is that agreed?

Hon. Senators: Agreed.

The Chairman: Then, on page 77, line 18, it is suggested that after the word "who" we should insert the word "knowingly". Is that agreed as well?

Hon. Senators: Agreed.

Hon. Mr. Basford: I am not sure, but can you knowingly acquiesce? If you acquiesce it means that you just do not care. You may not necessarily know, but you just do not care.

Mr. Ryan: Mr. Chairman, the point brought out by the minister is well taken. In the Securities Act of Ontario, where you run into that situation of acquiescence or these others, it contains the word "knowingly." In some of our sections we already have the word "knowingly" in there. Omission of the ordinary in this case might create a presumption against having some knowledge against what you are doing and not a mechanical doing of it. It is a matter of making our own bill.

The Chairman: I can conceive that you can acquiesce without appreciating the import of what you are doing.

Mr. Hopkins: It would not hurt.

The Chairman: You just go along with something.

Mr. Ryan: It has to be something more than a failure to do or pay attention. We will note the minister's statement in connection with acquiescence. The word may occur in some other legislation and we might want to quote it against him in regard to something else.

Hon. Mr. Basford: It seems to me a contradiction in terms. Maybe I should look at the meaning of acquiescence.

The Chairman: I have heard the expression of dignified acquiescence describing certain behaviours.

Senator Beaubien: The minister knowingly authorizes the permits.

The Chairman: If you want to break that up I suppose you could say knowingly authorizes and submits.

Mr. Ryan: Mr. Chairman, there is more involved than simply this. There are cases which I cannot refer to by name in England which I saw not too long ago in the old English Reports in which a director merely went along with all the other directors. As a result he was liable for a criminal offence. Then the element of *mens rea* came up as a defence and the court had great difficulty in determining whether it was an absolute liability on him or should have taken a more positive act or his acquiescence in sort of a negative sense constituted an offence in which he should have been liable under the terms of the statute.

It is a matter of extreme difficulty in this *mens rea,* because as I say each time the court has to consider it they have to look at the whole context of the act, such as the public policy to be invoked by the act and determine whether or not the *mens rea* element has been removed.

If you have "knowingly" in some cases and not in others there is the possibility that the court will construe this as an absolute liability. That is the reason these were brought to your attention and not that I recommend them to you.

The Chairman: We will leave it as is. Does the committee approve?

Hon. Senators: Agreed.

The Chairman: Mr. Hopkins has had a go at the suggestion you have made, incorporat-

ing also the suggestions which the minister made. The minister's suggestion referred to page 42 by which we would delete lines 15, 16 and 17 and then you start the line "called the commission" and then it goes on:

> Upon reasonable notice to the company except where the Commission is of the opinion that the giving of notice to the company in view of the allegations made by the applicants would likely prejudice any investigation ordered by the Commission, for an order.

Then there was some further discussion. This is show in our proceedings of this morning. At one point I said "give notice". Then I said to the minister: "I assume all the implications go with the giving of notice. On any hearing they may appear. Is that intended to be included? The giving of notice means nothing unless they are entitled to appear." Mr. Basford said, "It is notice of the application."

Following that, we have provided on page 43, to strike out lines 18 to 25 amd substitute the following. We would cover the question of a hearing and this is in line with part of what I proposed this morning; that is, where an application is made under subsection (1) by shareholders and notice is given to the company pursuant to that subsection, the minister and the company or their authorized representatives are entitled to appear in person or by counsel to examine the application and supporting material, to cross examine the applicants and to be heard at any hearing of the application. This is all predicated of course upon the commission deciding that they will give a notice.

Senator Flynn: This is my idea.

The Chairman: Of course it is based on the acceptance by this committee of the suggested amendment by the minister to subsection (1) of the new 112. It spells out what the position is at the hearing if the commission makes such an order.

Hon. Mr. Basford: It does not provide for what subsection (4) was intended to provide. Where there is an application by shareholders the shareholders shall have to give the minister notice that the minister may appear. This is another protection against frivolous applications. This only provides for when a notice is given to a company. We go on to provide, as subsection (4) does, for the right for the minister to appear where there is no notice given to the company.

The Chairman: You can say notice is given to the company.

Hon. Mr. Basford: Subsection (4) is concerned with the case where notice is not given, but the applicants must give notice to the minister so that he may appear and say, for example, that this is a frivolous and silly application and it should not be heard. That is the intention of subsection (4).

I am not opposing this amendment, but it does not go on and leave in the provisions of subsection (4).

Senator Molson: You mean to split it in two.

Mr. Ryan: There is another point that I would like to raise. Of course, I do not have the amendments in front of me. You will recall this morning discussion arose about the words "may apply" in respect of the minister so that subsection (1) has another amendment and which I suggest creates further problems in that section. It is one thing to say that the minister may refer to the Restrictive Trade Practices Commission, but for what and to do what? It may be that what we are trying to reach may cause an application to be made—shareholders apply—but the minister may cause an application to be made which will solve the problem mentioned this morning. When you come down to adding the words which have just been added, as I read them, they go in before an order directing an investigation. From a sheer drafting point of view, it is a rather awkward place to put them. If permitted by the committee I would like to discuss the form of the amendment on subsection (1), taking in what you have done this morning, plus this new matter and setting up a new form of that. We can do it in a few minutes. Possibly you can relieve us later on and we will try to meet the policies you are trying to reach.

The Chairman: How many minutes did you say you would require?

Mr. Ryan: That depends on whether we can agree. I think the two points can be reached by rearrangement of subsection (1), which I think is essential.

In subsection (4) the minister is quite correct that something has been lost. I do not know whether you intend that or not. It may be a combination of putting in a new subsec-

tion. I am not prepared to create a flow of words, because usually I submit up to seven drafts before I submit it to a body of this kind.

Mr. Hopkins: So do I if I have the time. I do not think the problem is in any way capable of resolution very quickly.

Senator Cook: We have agreed on the policy, have we not?

The Chairman: Yes.

Mr. Hopkins: If we agree on the principle, wording is not a problem.

The Chairman: What I was going to suggest is for us to move on to something else and maybe Mr. Ryan and Mr. Hopkins will adjourn and come back in possibly eight minutes.

Senator Flynn: Even if they are unable to agree in eight minutes...

The Chairman: If they are ready before the eight minutes we will hear them.

Senator Flynn: There is no necessity to come to a definite decision today.

The Chairman: I think Senator Cook raised the point. We have agreed on the policy and the principle and what is to go in. We can either hurry it or not. The only reason for speeding it up and doing it now is that we would reach the stage of a report sooner.

Senator Flynn: My understanding is that the Senate will come back on the twenty-ninth, and if there is a problem we could look at it then.

The Chairman: Maybe in the interest of the different things we are planning, the committee might have to meet on Tuesday afternoon.

Senator Flynn: Or Wednesday morning.

The Chairman: I would think Tuesday afternoon would have to be the time.

Senator Beaubien: We are sitting Tuesday night.

The Chairman: Why do we not leave it in this way, that we still retain Mr. Ryan and Mr. Hopkins, they can get together afterwards and draft it. We have approved in principle of these changes. We have noted the minister's position in relation to subsection (4). We have no desire to take anything away from him that subsection (4) gives but we are adding something and we have agreed on this.

Senator Flynn: In relation to subsection (4), that the notice should be given to the company and other directly interested parties, here it is mentioned in the amendment submitted this morning: "the company or their authorized representatives".

The Chairman: Yes.

Senator Flynn: I would suggest that sometimes it may be the case of directors who are directly implied.

The Chairman: Yes.

Senator Flynn: It may be the wording should say "the company or the others directly affected by the application", I think that is what you have in mind.

Senator Phillips (Rigaud): This is the point that I have in mind that the complaint may not be directed against one of the authorized agents, it may be directed against the directors or officers as such.

Senator Flynn: A company or any person directly involved.

Hon. Mr. Basford: This is one of the difficulties with this whole concept of giving notice before an investigation even starts. Often, you do not know who is involved and who should be given notice.

The Chairman: You know who is involved.

Senator Phillips (Rigaud): The commission will be able to judge. At least, we provided the discretionary power, but I think we ought to include that the notice, if it were decided to give notice, be directed not only to the company but other parties and interests.

The Chairman: It could be other parties named in the application.

Ssnator Phillips (Rigaud): Yes, that is what I meant. I am just directing the thought to Mr. Ryan.

The Chairman: Then, does this stand, that the committee has approved, subject to the wording?

Now, we had a question, at the last meeting, raised in connection with corporate trustees. We wanted some clarification. You might have a corporate trustee administering different estates in different areas in Canada and each one of those estates may have a certain

percentage of shares of one particular company. The sum total of their holdings in these various estates might exceed the amount which would put them in the position of being corporate trustees being an insider and having to follow all the requirements that insiders must follow under the act. The suggestion was made that we should put some limitation in there so that the qualifications to become an insider would have to be achieved in relation to a beneficiary, one beneficiary of that quantity of shares. We have an amendment here. May I read it to you. It is supposed to go in on page 14. In line 27, that we add a subparagraph (iii) and this is the way it reads:

> Page 14: Immediately after line 27 add, as subsection (iii) of proposed new paragraph 98, the following:
>
> Exception (iii) subparagraph (ii) of paragraph (b) of subsection (1) does not apply to a corporation that exercises control or direction as a trustee over the equity shares of a public company carrying more than ten per cent of the voting rights attached to all equity shares of the public company for the time being outstanding unless the trustee corporation exercises such control or direction on behalf of any one person who beneficially owns, directly or indirectly, equity shares of the public company carrying more than ten per cent of the voting rights attached to all equity shares of the company for the time being outstanding.

This is locking it in so that in the particular case there must be a ten per cent. You cannot achieve it by doing some addition in relation to a group of estates that are entirely unrelated. Have you any comments, Mr. Minister?

Senator Cook: Just a moment. As a matter of information, does this apply only to a trust company?

The Chairman: A corporate trustee.

Senator Cook: It could not be any other kind of corporation?

The Chairman: No.

Senator Beaubien: It is a trustee, not a corporation.

Senator Cook: If it could only apply to a trust company that is all right. That is why I asked the question. It is only a small point.

Mr. Hopkins: We had considered that, but Mr. Ryan preferred this wording and I went along with him and I think he is on good grounds in putting it in this way.

Hon. Mr. Basford: This section that is now in Bill C-4 is similar in wording to the Ontario Securities Act. I make two observations. One is that trust companies and corporate trustees appear to have had no difficulty under the Ontario act. We have been in communication with some of their officers to determine that. Secondly, the more these acts are different, the more it creates problems for people trying to determine whether the corporate trustee would not be an insider under the Canada Corporations Act, and would not be an insider if it had shares in a federal company. Is he an insider under the Ontario Securities Act or not? That is going to have to be determined by someone. Because the two acts in this respect are different, or would be different to this amendment.

Thirdly, I would point out that the provisions were put into the Ontario Act, I am advised, in 1968, so that the trustee under a voting trust agreement would be deemed to be an insider under the Ontario Act, and that of course would be the effect under the Canada Corporations Act and the effectiveness of the section in the cases of voting trust agreements would, in my view, if the amendment carried, be substantially reduced, as the section would not apply whenever the trustee holding securities on behalf of others, who in the aggregate may have equity shares of a company, carrying much more than ten per cent, but who separately do not own shares carrying more than ten per cent of the voting rights. Therefore, because the trust companies seem to have been able to manage well under the Ontario Act, because it may create some difficulties in differences of wording, and because it may jeopardize the section as it relates not to corporate trustees under an estate at will but as trustees under a voting trust agreement, we had to consider the position rather carefully.

The Chairman: Mr. Minister we did not conjure up this problem. It was the trust companies that stated the problem and I assume they stated the problem because they were unhappy about the way it was in the provincial legislation. In any event, it is like the minister this morning saying he did not think the Commons would accept a certain thing if we did it. We run our own show here, no matter what Ontario may do and, so far as

creating a conflict is concerned, the federal act creates some conflicts now and there is not any indication apparently that they are going to be resolved. Bill C-4 prohibits an insider from selling short. Under the provincial securities acts an insider may sell short, but he must notify the broker that he is selling short and the broker must tell on the exchange when he is making the sale, that he is selling short. So, if you are going to conjure up conflicts, there are some conflicts there now. If you are going to remove some, then let us remove all of them.

Hon. Mr. Basford: I have said, Mr. Chairman, many times over that it is our purpose to produce as much as possible an act of uniformity between the Ontario act and this act. In my view there is no need for a difference between them and we have tried to avoid it. In spite of the fact that trust companies have made this representation, I have pointed out that they have been able to operate quite successfully under the Ontario act and therefore the question arises: why should we create a lack of uniformity that in my view need not be created?

Senator Flynn: There is a stronger argument than that, I might say.

Senator Beaubien: Under this section a company like the Royal Trust would own 10 per cent of a great many of our big corporations which they would be administering as trustees. If the section is not amended, then every one of the officers of the Royal Trust would be insiders. A great many officers of the Royal Trust are administering and buying and selling the securities of these numerous companies of which they would be deemed to be insiders. How could they advise, according to the law, their clients to sell securities and so on, if they were deemed to be insiders? I think it has to be amended.

The Chairman: You have heard the proposed amendment, honourable senators. Is the committee in favour of the amendment as I have read it?

Mr. Ryan: May I make a comment at this time, Mr. Chairman? I think the attention of the committee should be directed to a fact that I have not heard mentioned yet, namely that this is subparagraph (3) we are talking about, a definition of "insider". I draw your attention particularly to the governing words:

> Any person who exercises control or direction over the equity shares of a public company carrying more than ten per cent...

If you are talking about a trustee or a trust company that holds shares on behalf of an account, there is no real problem. They do not fall under this.

Senator Beaubien: Yes, they do. In the majority of cases they are administering and deciding.

Mr. Ryan: But administering is not the governing word. It is "exercises control or direction over the equity shares of a public company". I think the attention of the committee should be directed to that, because you could have a situation where 90 per cent of the shares of a company are held by a trustee or a trust company that exercises the control or direction over these shares, and surely at that point they are as powerful in that company with the knowledge of that company as an individual who might exercise the same control or direction. I point this out to you because I do not think it was mentioned.

Senator Beaubien: Mr. Ryan, if they are controlling 90 per cent, as you say, of the shares of a corporation and they find that the corporation is going badly and they sell them out, can they be sued because they are insiders that are acting on inside information? If they cannot sell them out and cannot be sued, then they cannot discharge their duties as trustees.

Senator Cook: The beneficiaries can sue them, if they do not sell.

The Chairman: Yes, and they might very well.

I think we have shaken this back and forth sufficiently. Is the committee ready to approve? Those in favor signify. Contrary, if any? Carried.

Now, Mr. Minister, I believe you are aware of the problem Massey-Ferguson posed, and this item is an amendment intended to deal with that situation. The Massey-Ferguson position was that they hoped this amendment would overcome the problem concerning the grossing-up of assets and revenues by a private company with those of its affiliate companies for determining those companies which must report under section 121E. They say:

> We think that such wording would overcome our own problem of having our two federally incorporated subsidiaries whose assets and revenues are well under

the limits set in subsection 3(b) having to file statements merely because of their affiliation with the Massey-Ferguson Group, when their financial results are in any case consolidated with those of Massey-Ferguson Limited. It would at the same time carry out the intent of the Section, which, we understand, is to have full disclosure of the financial statements of private companies which might be affiliated with many small private companies none of which are presently filing financial statements.

Now, the amendment is a rewording of section 121E, (4), which is found on page 63. The amendment is as follows:

"For the purposes of paragraph (b) of subsection (3), the gross revenues and total assets of any other company with which a private company mentioned in the said paragraph (b) is affiliated within the meaning of section 121B shall be included in the gross revenue and the total assets of that private company, unless the private company and its affiliates are subsidiaries whose financial statements are consolidated with those of a holding company which files such consolidated financial statements in accordance with paragraph (b) of subsection (1)."

This deals with the problem. The question is what is the minister's view on it?

Senator Phillips (Rigaud): Does this not simply provide for consolidation? That is all it does.

The Chairman: That consolidation will be sufficient, yes.

Senator Phillips (Rigaud): Yes.

Hon. Mr. Basford: I have no comment, Mr. Chairman.

The Chairman: Does the committee approve?

Hon. Senators: Agreed.

The Chairman: Carried.

Senator Everett: Mr. Chairman, I really do not understand what we approved here.

The Chairman: Have you a copy of the amendment before you?

Senator Everett: Yes, I have.

The Chairman: What is there that you do not understand?

Senator Everett: I am trying to figure out what this does; what this amendment does. Subsection (4) seems to say that if you are affiliated you have to lump it altogether. Is that correct?

The Chairman: What it is designed to do is prevent the subsidiaries, whose assets and revenues are well below the amounts set out in Bill C-4, from having to file statements merely because of their affiliation with the Massey-Ferguson group.

Senator Phillips (Rigaud): As I see it, Mr. Chairman, it simply means that these are differentiated from the private companies on a consolidated basis.

The Chairman: That is right.

Senator Everett: Does it say this; if a company is filing a consolidated statement, you do not add in the affiliates that are already in the consolidation?

The Chairman: The affiliates do not have to file.

Mr. J. F. Grandy, Deputy Minister, Department of Consumer and Corporate Affairs: The information is in the consolidated statement and therefore does not have to be filed separately by the small company.

Senator Phillips (Rigaud): A private company, as I see it, and its affiliates that do not form part of a consolidated picture are covered by the present section 4, but in the case of consolidation, this particular section as presently drafted does not apply.

Senator Everett: Do I understand that for the gross revenue part of the section you get two affiliated companies and lump them together?

The Chairman: If you have two affiliated companies which are subsidiaries of a holding company, if the holding company files a consolidated return...

Senator Everett: But dealing with section 4 before you amend it. Do I understand that the objective of 4 is that if you have two affiliated companies, one doing a $6 million volume of business and the other one doing an $8 million volume of business that the two of them together are doing $14 million volume of business and therefore have to file

although individually they would not have to do so.

The Chairman: Individually they do not have to file.

Senator Everett: But does this mean that if those two companies have been consolidated in the statement they do not have to file separately. Is that what you are trying to say?

The Chairman: That is the intent of the amendment. Is this carried?

Hon. Senators: Agreed.

The Chairman: The next amendment stems from a memorandum which we received from a Mr. Cope of an outstanding legal firm in Montreal dealing with a situation where they had a company dealing with a number of objects, manufacturing objects, but they also had as an object the construction and operation of telegraph and telephone systems. This goes away back. They went out of the business of telegraph and telephone communications and concentrated on manufacturing. They were a Special Act company and now wish to become a letters patent company, but in view of the wording in Bill C-4, since they had this object of construction of a telegraph or telephone line, they would not, in the opinion of Mr. Cope, and I think his opinion was right, be able because of the exception made in Bill C-4 to apply for a letters patent incorporation because one of the reservations against applying for letters patent by a Special Act company is if it relates to the construction or operation of a telegraph or telephone system. Now we have worked out a draft which is before you and which strikes out lines 12 to 24 on page 6 of the bill and substitutes therefor the following:

> "(2) A company incorporated by special Act of the Parliament of Canada
>
> (a) whose objects to not include any of the objects mentioned in subsections (2) to (4) of section 5 or mentioned in sections 5A to 5C or
>
> (b) whose objects do include any of the objects referred to in paragraph (a) but the company has not been carrying on any of those objects for five or more years,
>
> may apply for letters patent continuing the company under this Part if at the time of the application the company is carrying on business and the application is authorized by a resolution approved by three-three-fourths of the votes cast at a special general meeting of the shareholders of the company."

Then there is the suggestion that should also be added:

> That Bill C-4 be amended by inserting after the words "letters patent," in line 12 on page 7 thereof the word "reduce,".

What was the intention there, Mr. Ryan?

Mr. Ryan: In terms of objects it could be limited to Canada or something else, but "reduce" means that you take away from the objects. It is necessary in these circumstances.

The Chairman: Then it would read "reduce" instead of "limit".

Mr. Ryan: No, it would read "reduce, limit or otherwise".

The Chairman: All right. We are very agreeable to meet your wishes, Mr. Ryan. Do you have anything to say, Mr. Minister?

Hon. Mr. Basford: These are the ones submitted to you this morning?

The Chairman: Yes. I am getting so accustomed to seeking your view on everything that even when you submit it I want to know that you approve of it.

Hon. Mr. Basford: Yes.

Senator Phillips (Rigaud): Mr. Chairman, referring again to Mr. Copes problem, I can well see that if they have not exercised their rights under this Act they could come under the letters patent provision. But have we made it clear in this wording that they cannot go back and ask for that power? Does it still remain embedded in their powers or has it been taken away from them?

The Chairman: Well, the point is that the moment they become a letters patent company they could not get that power.

Senator Phillips (Rigaud): Have we made it clear that the price of becoming a letters patent company is that they drop that power?

Hon. Mr. Basford: This I believe is the purpose of the second amendment putting in the word "reduce".

Senator Phillips (Rigaud): I want to make sure that they do not have it both ways. If they have embedded powers which they have not used for a long time and which they say they have not used and is now obsolescent and that they want to be a letters patent

company, that is all right as long as we do not leave them with the power.

The Chairman: I would think that the letters patent when issued would contain the restricted wording so that that power is not continued.

Mr. Ryan: The purpose is to make sure by the term "reduce" that it can be removed from their objects.

The Chairman: Are both these amendments approved?

Hon. Senators: Agreed.

Senator Everett: If one of the companies that is affiliated is a provincially incorporated company, what is the effect of subsection (4) of section 121?

Mr. Tasse: For the purpose of ascertaining whether the company should be reporting.

Senator Everett: For the purpose of ascertaining whether or not the federally incorporated company comes under the terms of the Act and secondly whether if, for example, the provincially incorporated company was a subsidiary of the federally incorporated company—whether you could require the provincially incorporated company to file.

Mr. Tasse: But there is no attempt under this act to require a provincially-incorporated company to file. Our intention is directed to the federally-incorporated companies, and for the purpose of ascertaining whether the company meets the test under subsection (4). Whether they are incorporated under the Canada Corporations Act or another act, they would be included.

Senator Everett: So a federally-incorporated company with $3 million of assets, if sales were not in issue, that was affiliated with a provincially-incorporated company of $3 million assets, would have to file?

Mr. Tasse: That is correct.

The Chairman: The minister has given me a proposed amendment which would involve amending Bill C-4 by striking out subsection (2) of section 38A, on pages 9 and 10, and substituting the following...

If you would look at section 38A I will then ask the minister to give an explanation of this.

Hon. Mr. Basford: Have copies of this been circulated, Mr. Chairman?

The Chairman: No. Have you copies?

Hon. Mr. Basford: Apparently there is only one other copy. Most of this is duplication. If I could address honourable senators to the bill, at page 9, and to subsection (2)(a) which reads:

> ...if
>
> (a) the company is to qualify under any other Act of the Parliament of Canada or any regulations thereunder for any licence or permit to carry on or continue its undertaking or any part thereof in Canada,

We would divide that into subparagraphs (i) and (ii), and add a new criterion, which would be subsection (ii):

> as a Canadian newspaper or periodical

Therefore, paragraph (a) would read:

> The company is to qualify under any other Act of the Parliament of Canada or any regulations thereunder for any licence or permit to carry on or to continue its undertaking or to carry on as a Canadian newspaper or periodical.

The purpose of the constrained-share provisions are to allow companies that by some act of Parliament have to have a Canadian content relative to ownership in order to get some licence or permit which is provided for in paragraph (a) to become a constrained share company, to qualify for the licence or permit.

The problem is that a newspaper, to remain a Canadian newspaper under section 12A of the Income Tax Act, of course, does not need a licence or a permit to operate; but in order to allow its advertisers to deduct their advertising as income tax deductions, they have to have Canadian ownership and have to qualify under section 12A of the Income Tax Act. So they do not need a licence or permit, but they have to qualify under the Income Tax Act. So, we are putting in this change to allow people either to become constrained-share companies, either to get a licence or permit under an act of Parliament, or to operate a Canadian newspaper or periodical.

I am not sure whether that is clear, but it is about as clear as I can make it.

The Chairman: It is clear to me.

Senator Martin: Why would not that apply to television?

Hon. Mr. Basford: Because television would come under the licence or permit sections, because you need a licence or permit under the federal act to operate a television station or a radio station, and the difficulty arose because someone with a newspaper, a publicly-held one, suddenly realized that his shares traded on the market, it was conceivable, could be traded away to Americans, and suddenly this company would not be qualified under section 12A of the Income Tax Act.

The Chairman: That is beneficial. Thank you.

Is this proposed amendment which the minister read approved?

Hon. Senators: Carried.

Senator Molson: That is the only other class of company that has to be covered, Mr. Chairman? I mean, banks and insurance companies are all under their own acts, so this is the only class of company that has not been previously covered?

The Chairman: No, if you remember, we amended the Insurance Companies Act, the Trust and Loan Companies Act so as to permit the situation by which they could become Letters Patent companies.

Senator Molson: Is there any provision for their being constrained?

Hon. Mr. Basford: There is another part of the amendment with which Mr. Tasse will deal.

Mr. Tasse: Yes. The other part of the amendment deals with holding companies which may hold shares in trust companies, insurance companies and the like, where they are statutory regulations concerning the ownership of shares and securities in this type of company. So the amendment that we are putting in would permit the holding company set up for the purpose of holding shares in that kind of company, to become a constrained-share company.

Senator Beaubien: Mutual funds and that sort of thing?

Mr. Tasse: If they were to hold securities in trust companies and insurance companies.

The Chairman: This is new subsection (iii), is it not?

Mr. Tasse: That is correct, Mr. Chairman.

Senator Molson: Excuse me, Mr. Chairman, on the point Senator Beaubien has made, that would not apply to mutual funds. They would not be constrained-share companies. What about the Montreal Trust, Investors Group and these sorts of relationships?

Mr. Tasse: Theoretically, I said, yes, but in practice I think it is very unlikely that this would happen because of the wide range of securities they hold. Whatever holding they may have in an insurance company is not likely to affect the ownership of securities in the insurance company itself, but is to prevent the insurance company from continuing as a Canadian company under the regulations under the Insurance Act.

The Chairman: In the charters of a number of these companies, you do have restrictions on the percentage of Canadian or non-Canadian ownership of shares, and what you are saying here in subparagraph (iii) is that the letters patent or supplementary letters patent of a public company may declare the company to be a constrained-share company when the company is one that is incorporated with the objects of investing in the shares of other corporations and it has a significant or controlling interest, directly or indirectly, through the holding of shares in a federally-incorporated trust, insurance, loans, small loans, or sales finance company.

The object here, I take it, is to prevent something happening indirectly that cannot happen directly. Is that right?

Mr. Tasse: That is right. It is to prevent a holding company from becoming an American controlled company.

Senator Molson: Have we already prevented the insurance companies—I know the banks are separate—but have we already prevented them under these changes from becoming taken over by foreign interests?

The Chairman: My recollection is that we have stipulated percentages in relation to shareholdings.

Mr. Ryan: Mr. Chairman, under the scheme of the Bank Act, trust companies, loan companies, small loan companies, the percentage is prescribed in the act at 25 per cent, or in the case of the banks it even goes to an individual holding; but the method of maintaining Canadian control in these companies is not by revoking their licence if they go offside, but by putting the persons who are

offside and become non-resident beyond the prescribed limits, preventing them from voting their shares and thus retaining control in Canadian hands.

The problem is not with these trust or loan or insurance companies *per se*. The problem is the companies that have invested in the shares of these companies. The investing company has no means of preserving itself onside so that it can protect its voting rights in the insurance shares it holds.

So, it is not the trust or loan companies that these provisions are concerned with, or this amendment; it is a company that holds shares and then protect themselves against going offside and disqualifying its voting rights that it otherwise would have had.

The Chairman: And it protects them in what way?

Mr. Ryan: It protects them in the sense that if they qualify under this they can make themselves constrained share companies, and then they can prescribe the limits of their foreign ownership and they can control it at the register.

The Chairman: They can prescribe, or is it done by regulation?

Mr. Ryan: They do it by the by-laws under the constrained share provision.

The Chairman: But are there any guidelines as to any percentages they can prescribe?

Mr. Ryan: There are no guidelines, Mr. Chairman, for the simple reason that the permutations are such that one cannot put guidelines in this act. One act of Parliament may say 33 per cent for an insurance company, or 25 per cent, or 50 per cent. A company that is hold shares has to adjust itself to that criterion. So this act itself in any statutory provisions leaves it flexible, so that the company by its own letters patent can adjust to whatever situation it has invested in.

The Chairman: Let me put the question in another way. Who gives such a holding company in those circumstances the qualification of being a constrained company?

Mr. Ryan: Firstly, the qualifications that are set out in this act that empowers them to be a constrained share company; secondly, the fact that they have to have the assent of their shareholders to that; and, thirdly, there are the letters patent that set out what the prescribed limits are.

The Chairman: Where does any authority from the department or from the minister come in? Where, if at all, is it exerciseable at any moment?

Mr. Ryan: That comes in only at the point where they apply for either Letters Patent incorporating them with these constrained share provisions, or at the point of the supplementary Letters Patent which involves a matter of whether he will issue them or not.

The Chairman: Thank you. Is this second amendment that we have been talking about approved by the committee?

Hon. Senators: Agreed.

The Chairman: There are consequential amendments which, I take it, the committee agrees to. On page 11, we strike out line 24 and substitute "section (6) of this section is guilty of". That is a consequential amendment.

Then on page 81, we strike out lines 25 to 33 and insert the following:

> shares or class of shares of a corporation would
>
> (i) preclude the corporation or any corporation in which it has a direct or indirect interest through the holding of shares in other corporations, as the case may be, from qualifying for any licence or permit pursuant to any Act described in subsection (2) of section 38A,

And we have been over that.

> (ii) under an Act of the Parliament of Canada, preclude the shares held by that corporation, or any other corporation in which it holds shares from voting any shares at a meeting of the shareholders of a federally incorporated trust, insurance, loan, small loans or sales finance company;

And then it carries on from line 34 as it is in the bill beginning with the words "but if the 'constrained-class' ". I hope I have made it reasonably clear. Is that amendment approved?

Hon. Senators: Approved.

The Chairman: Now, we have at least two items left. One concerns the representations made by Bell Canada last week, and the other concerns the question of validity. May I speak about the question of validity first.

There has been a lot of discussion, promoted, I think, by what I said in the Senate, and by a statement which I filed here and which came from Mr. Thorson, putting forward his department's view on the question of validity. Then I have had discussions with Mr. Ryan and Mr. Hopkins. The best sort of case that you might make on validity is, as Mr. Thorson put it in his memorandum, that it is not the desire of this legislation to impugn the competency of the provincial securities acts, but it is the purpose of this legislation to assert the competency of the federal securities legislation. That, of course, prompted me to say the other day: "Well, you seem to have parallel lines running there. You have the provincial securities acts, the validity of which is not being impugned, and you have the federal act, the competency of which is being promoted. Where do they meet?" The ordinary rule, as I stated the other day, is that parallel lines meet at infinity, and we have to try to see if we can move infinity up a little bit.

Therefore, I am concerned, if we just went ahead and pass the take-over bid sections and the insider trade sections, that we might create impressions, so far as federally-incorporated companies are concerned, that they just owe their allegiance and their duties and responsibilities to one place, namely, the federal authority.

That does not seem to harmonize very well with the concept that we have been discussing. The only concept that seems to be pertinent is what Mr. Ryan called the double aspect, and that is that conceivably on certain grounds the provincial legislation may be valid, and conceivably on certain grounds the federal legislation might be valid. My own feeling is that we have to put something in that will make it clear that we are not adopting one or the other, although when Parliament passes this bill we must assume it is passing something that it thinks it has the authority to pass, and, therefore, we do not have to assert the validity of the legislation in the bill.

I felt there should be a general provision to the effect that nothing in this act shall be construed as relieving a federally-incorporated company from meeting the relevant and applicable requirements of any provincial securities legislation.

Senator Martin: Would that add anything? Would that really change the present situation? I understand the reason for that phraseology, but it really would not alter the legal situation.

The Chairman: No. The legal situation, whatever it is, would be left there. If it is going to provoke a collision or a conflict at some stage, then it is going to do that. When some federal company may file, and then refuse to file provincially, then you have a problem right away. But, we are not attempting to solve that. If that develops then it is up to the courts to deal with it. This would not affect the legality or impugn the legality of Bill C-4 in this context. But, we would not be giving the back of our hand to the provincial securities laws because we are saying the federal legislation requires federal companies to file take-over bids on insider trading. But remember that your obligation under the provincial Securities Act is not satisfied by filing federally. You can either file or not, as you please. If you do not file, of course you may be subject to prosecution. I am not wedded to that exact language, but that is my thought on the matter as to how we might resolve this question. It goes a long way towards resolving a problem which I had, and basically I may still have, as to the question of validity, but for the moment, believing that politics is the art of the possible, this looks like a reasonable compromise. Do any of the senators have any views to express?

Senator Martin: I would like to know what Mr. Basford thinks.

Hon. Mr. Basford: Mr. Chairman, all I can say is that we, as ministers, have to take the advice of the law officers of the Crown. I want to put on record that we are considerably troubled by such provisions, for I am not entirely clear as to what the implications are for writing into federal statutes provisions that this act does not excuse people from any provincial obligations. Surely obligations of a company, be it federal or provincial, are a matter of constitutional law. We are not going to change the Constitution by sections in this act.

We are very troubled as to where this kind of section leads us, and we do not put into other federal laws that this excuses or does not excuse people from their provincial obligations. Those obligations and the obligations of citizens and of companies is a matter of law to be determined by the courts. Does this section assist the courts or doesn't it? We really do not know. We do not quite know what a judge would do with this section in

front of him. As a matter of it being practical, I would say, and I would be talking about this constitutional theory, that some concern on our part as to where this takes us. As a matter of practice I want to make very clear that both under bill C-4 and under the Ontario and western Securities Acts there are exemption procedures by which companies may apply to one agency or another for exemption from certain provisions of the act. Those exemption provisions are in these acts, both federal and provincial, to avoid such functional difficulties that may exist between them.

As a matter of practice, I submit that the situation be looked after by the exemption procedures in both federal and provincial acts. As a matter of theory we are very troubled as to where this kind of provision leads us and whether it changes anything or not. This, we are not able to say. What a judge would do with that sort of section we are also unable to say. Therefore, because it is quite troublesome or could be worrisome, we would hope that it not be put in. It is certainly a most unusual provision.

The Chairman: It is not as unusual as you may think it is. If I had a short time I think I could turn up some situations. I do recall right away that we kept passing year after year a provision protecting certain unions on the west coast against the impact of the Combines Investigation laws and we found it easy there. Maybe it was because it was federal jurisdiction.

Hon. Mr. Basford: All we said is that we held that they were valid within the jurisdiction of the Combines Investigation Act, and we have passed legislation where we would not use the Combines Investigation Act.

The Chairman: In a sense, yes, and in another sense, no. You have almost got an impasse here. You are not contesting provincial securities validity and you are asserting federal securities validity. It seems under those circumstances that the statute owes something to the public who are subject to the act to know that this act requires them to follow the provisions of C-4, but in following them it does not grant them any relief against obligations that may exist outside this act in relation to the same transactions.

Hon. Mr. Basford: I know what your answer is going to be, but I still ask the question. It seems to be a valid one and having discussed this with you I am not entirely satisfied with your answer. What is the position if we use your wording of a company that applies to the Ontario Securities Commission or some provincial agency for an exemption? I know you argue it the other way. One company argues that they are not entitled to the exemption because a section in the federal act says that they must comply with the provincial act and nothing shall relieve them from any obligations.

The Chairman: This is the double aspect and where you get into the area of conflict.

Hon. Mr. Basford: This is why a section like this troubles us.

The Chairman: You argued very strenuously this morning that we should not be prevented from passing laws in relation to an associate company, because it might be ineffective. Then I put the question to you whether we should be so vitally concerned by a clarification of the two positions so far as the federally incorporated company is concerned in this bill. We point out to them that you must comply with this law that is being enacted, but you are on your own as far as provincial securities legislation is concerned. All we are saying is that when the provinces get after you you cannot say that you filled federally and that lets you out, because it does not.

Hon. Mr. Basford: On the advice of law officers we are not sure where this wording in a section will take us. Whether the CPR or Trans Canada Pipe Line or Noranda or to what extent they are subject and have to comply with provincial regulations and provincial laws—securities laws or any other laws—is surely a matter of law that is not settled by some wording in this act.

The Chairman: Mr. Minister, I should not be saying "I", but I took the position that there was no question but that the provincial securities legislation was valid. Whether the implication from that is that the federal legislation is not valid or whether the two can exist is a question that may have to be settled in the courts some time. I tried to settle on the most innocuous thing that would make the position in which I find myself a legitimate compromise and I think you are magnifying this. All we are doing is making a clarification by just saying that you are required to file here, but you don't, so far as relevant or applicable or provincial law is concerned in this field and that this is no relief to you in that. That is all.

Hon. Mr. Basford: Mr. Chairman, all I can do is properly put to you the advice we received from the law officers of the Crown.

Senator Phillips (Rigaud): May I make a suggestion. I see the difficulty and I am here to see what we can do with the difficulties, as are the other senators. If we were to introduce a clause something like this it might help: "compliance with provincial legislation whenever relevant shall not exempt any company incorporated under this act from compliance with the provisions of this act".

I would do it in the reverse, that this is a federal statute that we are enacting, that we want to be sure that companies who come under this act comply. All we say is that compliance with provincial law does not exempt any company from compliance with the laws we are passing with respect to companies incorporated under our jurisdiction. I would think if we were to consider any wording at all, that is about the most innocuous wording to meet the issue.

The Chairman: As far as I am concerned it does not matter how you say it.

Senator Phillips (Rigaud): I any event, I wonder if someone would be good enough to take this down for at least a consideration. I am obviously doing it in reverse and insisting on compliance with federal statute.

The Chairman: Would you read that again, senator?

Senator Phillips (Rigaud): "Compliance with provincial legislation whenever relevant shall not exempt any company incorporated under this act from compliance with the provisions of this act."

Hon. Mr. Basford: That is agreeable to me.

Senator Phillips (Rigaud): I am complimented.

The Chairman: Senator, you have achieved the impossible.

Senator Molson: There still seems to be a slightly forgotten man, that is, the corporation itself, or the people in the corporation themselves. What prospects have we of getting uniformity in the provincial and federal legislation at a reasonably early date? Have we some prospect, so that in matters like filing it becomes relatively simple whether you repeat it or not? Is it possible that we can look forward to getting a reduction of the number of demands on returns, through uniformity?

Hon. Mr. Basford: I am sympathetic to the point you have raised, and so are my officials. As I said in my opening statement, two meetings with the provincial officials, and the amendments we proposed ourselves and which were made in the other place, have eliminated functional difficulties stemming from any lack of unirormity. It will take a little while to work out, as a matter of practice, some of the exemptions that must be granted to companies by one authority or another. I hope, and I am confident, in so far as Ontario and the four western provinces are concerned, which have generally uniform legislation, that within a matter of a very short time we can eliminate the problems you speak of.

Of course, we cannot eliminate the problems relative to securities and people having to clear prospectuses, which are not dealt with here. For example, on the question of filing insider reports, where it may be required under Bill C-4 and under provincial securities acts, I think the problems of filing and of duplication should be worked out quite quickly.

Senator Molson: It is terribly important because today it is a terrible maze and so many people are kept so involved in corporation life on these problems and certainly it is desirable.

Hon. Mr. Basford: If we eliminated all of these problems my friend Jim Younger would not have very much to do.

Senator Molson: There are a lot of people who would not have much to do, but the prices would be better.

The Chairman: Senator Molson, that is the reason why some years ago, when we were amending the Canada Corporations Act, we put in that provision in relation to prospectuses, that Ottawa had the right to demand, but they could accept the filing which has to be done under the provincial act. The reason was to cut down on the paper work. It may be we will achieve that here.

Senator Molson: That is what I want. But we are still a long way off. I was really asking the minister if he was optimistic that we were going to close the gaps in the not too distant future, because it is an awful strain on the corporate function.

Senator Martin: I guess we are not near it.

Senator Molson: I am afraid not.

The Chairman: It is unfortunate that we could not deal with it as we did in the case of the unemployment insurance some years ago. We had the constitution amended and you had one statute.

Senator Molson: But the money went with it.

Senator Everett: There is one point I would like to raise.

The Chairman: First of all, Mr. Minister, there was a point raised by Bell Canada, who felt they should be entitled to qualify for letters patent. In the bill as it came to us, they, together with banks, are denied that privilege. Have you any comment to make on the reasons or grounds for that denial.

Hon. Mr. Basford: One has to consider only two companies here, the Bell company and, in my own province, the British Columbia Telephone Company, both of which operate monopolies within their market areas. I suggest that members of this house and certainly of the other place would wish to exercise whatever little control is exercised by way of having to require special acts, that members of both houses would want to exercise the kind of control that is provided in that way and therefore this should not be provided for by letters patent. The companies are operating natural monopolies within their market areas which affect hundreds of thousands of people and I would suspect that this would be the view of members of both institutions that they would not want to give up that control.

The Chairman: I thought there might be some questions of the delicacy of the whole field of communications and the vital importance of that field and the development of that field. These things are moving pretty fast.

Hon. Mr. Basford: This is a very valid consideration. A committee of this house has been giving some thought to this whole subject and I know a committee in the house is. Until we sort out just what are the corporate laws that should be applicable in a very changing area, as you suggest, I think we should go slowly on these theories. In subsequent revision of the Canada Corporations Act coming, it is hoped, in the not too distant future, we could examine the question, as these communications problems will become more apparent and we might know what the solutions are, better than we do now.

The Chairman: You do have a method of control of rates, but this is a very practical method of control of the money supply, because if they want an increase in capital they have to come to Parliament. If they want to borrow money they have to come to Parliament to get this financial approval.

Senator Cook: It almost looks as if it is the question of public policy versus private convenience, and if the public policy is that way it seems to me it would be as well to leave it alone.

The Chairman: It may be that the suggestion to make a change to letters patent might be moving too quickly, too soon.

Senator Phillips (Rigaud): I support that view, Mr. Chairman. In view of the minister's observations, I think we are invading almost on government policy.

The Chairman: And on what the chairman said.

Then, the view of the committee is that we do not deal with that section of the bill, that we do not make any changes in it. Is that agreed?

Hon. Senators: Agreed.

The Chairman: Is it possible that, if Mr. Ryan and Mr. Hopkins got together for half an hour, we could reconvene and accept their draftsmanship, which might end this hearing today?

Hon. Senators: Agreed.

The Chairman: Before adjourning for that purpose perhaps we should give Senator Everett a chance to finish.

Senator Everett: I am merely concerned, Mr. Chairman, about the Massey-Ferguson amendment. It refers to the private company and its affiliates that are subsidiaries of a holding company. I can envisage in a situation such as Massey-Ferguson is concerned with, of a holding company and two private affiliates, that the private affiliates do not have to file. The holding company can file for them.

The Chairman: It consolidates.

Senator Everett: If it files a consolidated statement. I wonder what the situation is, if you have a holding company with one sub-

sidiary or a holding company with a subsidiary with another subsidiary and with another subsidiary. In other words, I wonder if it would not be better if there were a statement to the effect that if a company files a consolidated statement that is sufficient for the purposes of the act.

I can see the peculiar language in this amendment letting Massey-Ferguson or certain companies that are in that position file consolidated statements whereas other companies that are in essentially the same position will not be able to file a consolidated statement. I presume it is the intention of the minister and his officials that the filing of a consolidated statement will satisfy the act whether it is a private or public company.

Mr. Grandy: I am not sure that the problem is a real one. The amendment that was adopted today arising out of the Massey-Ferguson submission deals with the case where the private company and its affiliates are subsidiaries whose financial statements are consolidated with those of a holding company which files a consolidated return.

Senator Everett: Not a consolidated return, surely. It publishes a consolidated statement. The word "return" refers to the specific act under the Income Tax Act.

Mr. Grandy: The wording here is:

> .. subsidiaries whose financial statements are consolidated with those of a holding company which files such consolidated financial statements in accordance with paragraph (b) of subsection (1).

So there is a consolidated filing by the holding company.

Senator Everett: We could agree not to use the word "return".

Mr. Grandy: Yes. Presume the holding company is a private company and it has one or two subsidiaries; being a private company it does not file a consolidated financial statement. That is the other situation.

Senator Everett: It might choose to file, however.

Mr. Grandy: It might choose to do so in which case this might apply, presumably.

Senator Everett: Let us take the case of a company, private or public, which is a holding company holding one subsidiary. It files a consolidated return. According to this it would file the consolidated return and would also be required, because it has only one subsidiary, to file a statement on the part of the subsidiary. On the other hand, Massey-Ferguson, with two susbidiaries, would not be so required.

Mr. Chairman, my recommendation would be that companies which file consolidated statements should not be required to file individual statements from the affiliates so consolidated. I believe that is your intention, gentlemen.

The Chairman: That would be a completely general provision.

Senator Everett: Yes. Only because this particular provision would rope in some companies and not others.

The Chairman: This provision is limited to private holding companies that have subsidiaries.

Senator Everett: Not so, Mr. Chairman, because Massey-Ferguson feel that it refers to them and they are a public company having two private subsidiaries.

Senator Phillips (Rigaud): With the amendment it now covers them, Senator Everett.

Senator Everett: But they are talking about a public holding company with two private subsidiaries.

Senator Phillips (Rigaud): There is no such thing as a consolidated return under the Income Tax Act, incidentally. We must be thinking of returns under this particular act.

Senator Everett: The terminology is consolidated statements filed under the terms of this act instead of consolidated returns. I think you do use that terminology.

Mr. Tasse: Yes, that is the wording I use.

Senator Everett: I do not want to delay the committee, Mr. Chairman.

The Chairman: No, there is something in the point you have raised.

Where is the reference you make to consolidated financial statements in accordance with paragraph (b) of subsection (1)?

Mr. Tasse: It is in section 121E in Bill C-4, Mr. Chairman.

The Chairman: In subsection (1) of that section they refer to a copy of the financial statement.

Senator Martin: It refers to consolidated statements, Mr. Chairman.

Senator Everett: I wonder if we could rectify it by taking out the words in the Massey-Ferguson amendment in the eighth line thereof which read: "are subsidiaries whose".

Senator Martin: That is what I was referring to.

Senator Everett: It would then read as follows:

> "For the purposes of paragraph (b) of subsection (3), the gross revenues and total assets of any other company with which a private company mentioned in the said paragraph (b) is affiliated within the meaning of section 121B shall be included in the gross revenue and the total assets of that private company, unless the private company and its affiliates' financial statements are...

And I would further suggest changing it from the words "holding company" and so on to:

> ...consolidated with those of one of the affiliated companies which files such consolidated statements in accordance with paragraph (b) of subsection (1).

So that if a consolidated financial statement is filed, then that includes all the companies that are a part of that group and the individual companies do not have to file.

The Chairman: My trouble, Senator Everett, is that I cannot find where there is a definition or a requirement to file a consolidated return.

Mr. Tasse: There is section 121B permitting the holding company to file. It is not in the bill, Mr. Chairman. It is in the current act.

The Chairman: Section 121D. Is that what you said?

Mr. Tasse: Yes. The first subsection says:

> Any company referred to in this section as a holding company may include in the financial statements...

The Chairman: Yes, it speaks about filing statements of the subsidiary companies in consolidated form. So there is that provision now. Have you anything to say about that?

Hon. Mr. Basford: No, Mr. Chairman. My experts seem to be somewhat confused or unsure about this.

The Chairman: Well, we will adjourn for half an hour and Mr. Ryan and Mr. Hopkins can get together and agree on their wording and maybe Mr. Tasse will be able to say something to us about it afterwards.

The committee adjourned.

The committee resumed at 4.20 p.m.

The Chairman: Honourable senators, Senator Everett had a question. I understand that all our consultants have come up with an idea which they think will meet the question you were wrestling with. Have you your copy, Senator Everett?

Senator Everett: I think you have it, Mr. Chairman.

The Chairman: Well, the proposal is this. It goes as originally planned, and I will tell you where it departs.

> For the purposes of paragraph (b) of subsection (3), the gross revenues and total assets of any other company with which a private company mentioned in the said paragraph (b) is affiliated within the meaning of section 121B shall be included in the gross revenue and the total assets of that private company,

And here is where the new begins:

> unless the financial statements of the private company and its affiliates, if any, are consolidated with those of a holding company that files such consolidated financial statements in accordance with paragraph (b) of subsection (1).

The Chairman: Hon. does that suit you?

Senator Everett: That solves the problem in my mind, Mr. Chairman.

The Chairman: Then, although we had approved of the earlier draft, our approval is now withdrawn and we now approve what I have just read, is that correct?

Hon. Senators: Agreed.

The Chairman: We are flexible in that regard.

I think there is the draft on putting the two pieces together, on the investigation.

Hon. Mr. Basford: This is the amendment on page 42 dealing with the giving of notice, and this one on page 43 on the rights of the party upon notice having been given.

The Chairman: Page 42, we have a wording here. It is:

> Strike out lines 10 to 20, inclusive, and substitute therefor the following:
>
> of the company may apply, or the Minister on his own initiative may cause an application to be made, to the Restrictive Trade Practices Commission established under the Combines Investigation Act (hereinafter called the Commission), upon reasonable notice to the company or other interested party or *ex parte* if the Commission is of the opinion that the giving of notice would in view of the allegations made by the applicants or on behalf of the Minister unduly prejudice any investigation that might be ordered by the Commission, for an order directing an investigation of the company in respect of which the application is made.

I had better give you the other one, because the two go together. On page 43 it is proposed to strike out lines 18 to 25 inclusive, and to substitute therefor the following:

> (4) Where an application is made under subsection (1) by shareholders, the applicant shareholders shall give the Minister reasonable notice thereof; and the Minister and the company or any other party who has been given notice of the application, or an authorized representative of any of them, is entitled to appear in person or by counsel to examine the application and supporting material, to cross-examine the applicants and to be heard at any hearing of the application.

The combination of those two amendments deals with the situation at the stage where an application is made, and before the commission has directed the appointment of an inspector. This covers the various points that I was raising.

There was another one that I raised that was really an offer to the minister to meet the point that he raised. But he does not want it so, therefore, we do not give it. That was about impounding the documents. Is this satisfactory to you, Mr. Minister?

Hon. Mr. Basford: Yes, it is, Mr. Chairman.

The Chairman: Does the committee approve these amendments?

Hon. Senators: Agreed.

The Chairman: Is that the end of your drafting, Mr. Ryan?

Mr. Ryan: On this matter, Mr. Chairman, or permanently?

The Chairman: It cannot be permanently. This would appear to cover all the points that we have in mind. Is there anything you wish to add, Mr. Minister?

Hon. Mr. Basford: I am a little unclear as to what happened to Senator Phillips' amendment. I am not sure where it was placed in the bill.

The Chairman: I suggested that it go in as section 36, and then section 36 can be renumbered section 37.

Hon. Mr. Basford: So Senator Phillips' amendment will be section 36, and section 36 is renumbered section 37.

The Chairman: Yes. Is that agreed?

Hon. Senators: Agreed.

The Chairman: Then that covers the work we have to do. Thank you very much, Mr. Minister, for your attendance, and for the excellent way in which we got along together.

Hon. Mr. Basford: Thank you, Mr. Chairman. Your feelings are reciprocated.

The committee adjourned.

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 41

THURSDAY, OCTOBER 1st, 1970

Complete Proceedings on Bill C-163,

intituled:

"An Act to provide for the establishment of a Standards Council of Canada"

WITNESSES:

Department of Industry, Trade and Commerce: Office of Science and Technology: Dr. S. Wagner, General Director; Mr. H. C. Douglas, Director (Policy); Mr. H. B. Scully, Industrial Standards.

REPORT OF THE COMMITTEE

22719—1

THE STANDING SENATE COMMITTEE ON BANKING,

TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (*Rigaud*)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (*Ottawa West*)	Hays	White
Cook	Hollett	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDER OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, September 30, 1970:

"Pursuant to the Order of the Day, the Senate resumed the debate on the motion of the Honourable Senator Denis, P.C., seconded by the Honourable Senator Fournier (*de Lanaudière*), for the second reading of the Bill C-163, intituled: "An Act to provide for the establishment of a Standards Council of Canada".

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Denis, P.C., moved, seconded by the Honourable Senator Fournier (*de Lanaudière*), that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—

Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

22719—1½

MINUTES OF PROCEEDINGS

THURSDAY, October 1st, 1970.
(69)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to consider:

Bill C-163 "An Act to provide for the establishment of a Standards Council of Canada".

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Benidickson, Burchill, Carter, Desruisseaux, Everett, Gelinas, Hollett, Kinley, Molson and Phillips (*Rigaud*)—(12).

Present, but not of the Committee: The Honourable Senator Sullivan—(1).

In attendance: E. Russell Hopkins, Law Clerk and Parliamentary Counsel

WITNESSES:

Department of Industry, Trade and Commerce:

Dr. S. Wagner, General Director,
Office of Science and Technology;

Mr. H. C. Douglas, Director (Policy),
Office of Science and Technology;

Mr. H. B. Scully, Industrial Standards,
Office of Science and Technology.

Upon motion it was *Resolved* to report the said Bill without amendment.

At 10:00 a.m. the Committee proceeded *in camera* and adjourned at 10:50 a.m. to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

REPORT OF THE COMMITTEE

THURSDAY, October 1, 1970.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill C-163, intituled: "An Act to provide for the establishment of a Standards Council of Canada", has in obedience to the order of reference of September 30, 1970, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Thursday, October 1, 1970

The Standing Senate Committee on Banking, Trade and Commerce to which was referred Bill C-163, an act to provide for the establishment of a Standards Council of Canada, met this day at 9 a.m.

Hon. Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, this morning we have one bill, C-163, to provide for the establishment of a Standards Council. It is most likely that this is the last bill that we will have in the current session.

Bill C-163 was dealt with in the Senate yesterday and on the previous evening. Representing the Department of Industry, Trade and Commerce are Dr. S. Wagner, General Director, Office of Science and Technology; Mr. H. C. Douglas, Director (Policy), Office of Science and Technology, and Mr. H. B. Scully, Industrial Standards, Office of Science and Technology.

Dr. Wagner will make the opening explanation.

Dr. S. Wagner, General Director, Office of Science and Technology, Department of Industry, Trade and Commerce: Mr. Chairman and honourable senators, perhaps it would suit your purpose best if I give simply a short general background to the purpose of the bill and then allow you to ask questions in detail on it. Is that the way in which you would wish me to proceed?

The Chairman: Yes.

Dr. Wagner: The purpose of the bill essentially is to co-ordinate within the country all of the activities which are currently going on in voluntary standards. It is useful here to distinguish between a voluntary standard and a mandatory standard.

Industry at the present time already adheres in many areas to a set of voluntary standards, which are designed primarily to facilitate trade. There is a variety of organizations in the country which do this now. More specifically, however, there is a variety of areas in which standards do not adequately exist.

With the increasing complexity of Canadian industry, with the development particularly of our secondary and our tertiary industries, it becomes of increasing importance for us as a country to co-ordinate the area of voluntary standards, that is, standards which apply to industries to assist them in increasing their trade amongst one another and also with other countries.

I think it is safe to say now that everyone in most sectors is pretty well agreed on the desirability of having a co-ordinating role, that everyone concerned should have a voice in this role, and that the Government could help to institute, if you will, the parliament of standards.

This particular council will be set up in such a way that it is effectively a form of Crown corporation. It will have a very great deal of autonomy. It will comprise some public officials at the federal, provincial and municipal levels. Primariy, it will comprise representatives of industrial associations.

It will have also an important secondary role, and that is, when the day comes that Canada does convert to the metric system, it will have the responsibility for co-ordinating conversion in the industrial sector.

It will have another important role outside the country, in the international sphere. Now that such agreements as GATT concerning tariffs are well down the road, now that tariffs are being reduced and are becoming a less important element in restraint of trade between countries, we are becoming increas-

ingly aware that there is another kind of barrier, called a non-tariff barrier, which is being erected in restraint of trade. One of these is in the area of standards. So Canada, as a country and as an entity, has a most important role to play in insuring that we are not barred from certain foreign markets because of the fact that we do not comply to standards. In other words, the bar is not in relation to tariffs but is in relation to standards.

Some of this kind of thinking is already going on in certain quarters. Most people in the community who are acquainted with standards, in both government and industry, are aware that our role in the international sphere is not really great enough. So this will be one of the other important roles of the council.

I think what I will do, Mr. Chairman, is stop for the moment. Possibly the committee might have some questions to ask.

The Chairman: Dr. Wagner, this bill envisages a standards commission or council; where does the work of that council start? Where is the point of beginning? Is it a study of standardizing materials or of a form of structures?

Dr. Wagner: No. I would have said that I, personally, would visualize a council like this starting by bringing together all of the standards-forming organizations.

Senator Molson: How many of those voluntary organizations do you believe now exist?

Dr. Wagner: There are half a dozen or so active ones in Canada.

The Chairman: Are they in the private sector or the public sector?

Dr. Wagner: One is in the public sector; the others are in the private sector.

The Chairman: What is the one in the public sector?

Dr. Wagner: It is the Canadian Government's Standards Specifications Board.

The Chairman: The provinces have no such organization?

Dr. Wagner: So far as I know there is no identifiable provincial organization.

The Chairman: What authority have you at the present time to implement anything that you or these bodies might seek to have observed by way of rules of construction or safety of buildings or things of that kind? Have they any teeth in their operations?

Dr. Wagner: It is all on a consensus arrangement.

The Chairman: It is by consensus?

Dr. Wagner: This is the way standards are written now, sir.

The Chairman: The way you propose to write them are you going to have some authority behind rules or directions that you give?

Dr. Wagner: Any standards that are written by bodies that adhere to the Standards Council, or standards which are written as a result of initiatives taken by the Standards Council will be done as a result of consensus. These are voluntary standards.

Senator Everett: On page 3 of the bill, Dr. Wagner, under "Objects and Powers" in subclause (2) paragraph (e) it is stated that the council can "approve standards in those fields submitted by organizations accredited by the Council..."

This would be a voluntary matter, I gather from what you say, but once you have approved those standards, among those who have agreed to be bound by them is there any binding authority from that point forward?

Dr. Wagner: Once the council approves a standard as a council, then that goes into its list of standards so that it becomes one of the standards on its approved list. But let us take an example. Supposing you manufacture resistors as an electrical manufacturer, and let us suppose that yesterday the council agreed on standards for those things and that they are all listed—colour codings, tolerances, wire sizes, safety ratings, et cetera. Suppose you as a manufacturer decide that you do not want to do those; the council cannot force you to do them. The point of the matter is that there is an attempt in this kind of field in industry to come to an agreement. You would want to get most of the people represented to agree that this is desirable, and then do it as a country. If the Government felt for some reason that it was essential for the safety of the population that everyone adhere to those standards and therefore passed a law, then that would be outside the province of the council. That would be a mandatory

standard applied by the department. Examples of that would be standards set by the Food and Drug Directorate, the Poisonous Foods Act, the Hazardous Products Act, and so on. We are talking about industrial standards here, and there has to be a focal point somewhere in the country for making those standards. Most countries are starting to do this sort of thing.

The Chairman: Apparently that is the only objective you have, because in clause 4, subsection (1) the objects of the council are stated to be to foster and promote voluntary standardization.

Dr. Wagner: Yes, to promote and foster voluntary standardization, yes, sir.

The Chairman: And you say that if you want to go beyond the stage of voluntariness, then, depending on the nature of the thing you were dealing with, you would go to whichever department would normally be involved. But here you are dealing with construction and safety of buildings, and so on, and what I am wondering is just what department would pick that up and make enforceable any voluntary guidelines you would lay down in respect of safety, and so on.

Dr. Wagner: Suppose, for example, that in the field of housing a certain number of standards had been worked up over the years and that in the course of time the Central Mortgage and Housing people, or the people involved in the national building code and the National Research Council saw that it would be desirable to make one of these standards mandatory, then they would go to the relevant department to whom they report and they would ask the minister to make it mandatory.

The Chairman: I am interested in that word "relevant". In this field where you have your object as being "to foster and promote voluntary standardization" relating to construction and so on, what department is it to whom you would go in connection with some safety directions in relation to structures? What department of Government would it be? Would it be a federal department or a provincial department to which you would go?

Dr. Wagner: There is no requirement in that respect. The requirement here is merely that we have a body that occupies itself with voluntary standards in order to keep our industry as healthy as possible, because this is a component of being in industry now. In the process of doing this the council has representation from the federal Government departments most likely to be involved, as well as one representative from each provincial department and representatives interested at the municipal level. One would expect this to be a two-way dialogue. It could be that the council might draw the attention of a department to the fact that in respect of a standard just passed it might be more appropriate to have a look at it to consider whether it would be desirable to have it more than voluntary, but the council itself does not have authority to do that. It could be that a member of the council might himself notice something and then set some process in action whereby one would end up at some level of government making a standard mandatory. After all, in the building field, many of the regulations are municipal regulations. They are at that level.

The Chairman: Anything you would say in relation to them would only be persuasive.

Dr. Wagner: That is right.

Senator Phillips (Rigaud): I am quite intrigued, Dr. Wagner, by the last statement you made in your introduction. You said that barriers were presently being set up in certain quarters with respect to standards to offset tariffs, and so on. Have you any examples of that that you could give.

Dr. Wagner: There is at the present time a group of European countries, three in particular, who could have some reasonable effect on us, who are looking at a system of standardization in the electrical industry at the present time. From their point of view, the rationale behind it is that they believe they would increase their market base. In this particular industry, if several countries had the same kind of standards, then a manufacturer in any one of those countries would find that the markets available to him on that basis would be much more accessible than previously. That is the situation with respect to the markets of the three countries I am alluding to. These standards do not necessarily quite conform to the standards we now have in this country, and at the moment other countries have not been invited to participate. We believe that we are going to get ourselves invited to be an observer state, but we are making it clear, and the Americans are attempting to make it clear, that we do not like the way it looks at the present time. But

these countries are maintaining that at the moment this is just a trial run and that in future everybody will be invited to take part.

Senator Phillips (Rigaud): Under the GATT Agreement, do these countries have the right to approve their standards and thereby restrict trade?

Dr. Wagner: Probably this kind of thing would contravene some of the items of the GATT Agreement in principle. Nevertheless, as you know, it can be very time consuming to effect the items of such an agreement. One of the things one should do is to make sure one has enough qualified people looking at international matters to be acquainted with them and to be taking action with respect to them.

Senator Phillips (Rigaud): I should like to direct your attention to page 3 of the bill, clause 4, subclause (2), paragraph (g), where you speak of establishing and registering under the Trade Marks Act only. Could that be good housekeeping concepts, that under the Trade Marks Act you have some sort of label, some sort of indication that the product had received the approval of *Good Housekeeping*, for example, with respect to things to buy and make.

Dr. Wagner: It is an identifying mark. I will let Mr. Douglas comment on this since he has been intimately involved in working on the wording of it and knows something of its background.

Mr. H. C. Douglas, Director (Policy), Office of Science and Technology, Department of Industry, Trade and Commerce: What we are referring to here, Mr. Chairman, is simply what is commonly known in standardization activities as standards marks. You may be familiar with the mark you see on a good many electrical appliances the C.S.A. mark of the Canadian Standards Association showing that the product is approved and certified by that association. You also have probably seen the Underwriters Laboratories mark, U.L., on electrical wiring. It is the same type of mark. The British call it the Kite Mark used by the British Standards Institution. These are marks registered under the Trade Marks Act and which are used and licensed by standards associations so that manufacturers can comply with their standards.

Senator Phillips (Rigaud): Are you contemplating an overall symbol? When you propose establishing something under the Trade Marks Act, will that be an overall Canadian symbol?

Mr. Douglas: That is essentially what is contemplated, that there would be an identifying symbol or mark which could be applied to a product whose standards have been approved by the Council.

Senator Phillips (Rigaud): I think insofar as international trade is concerned, this is a remarkable achievement, that products coming from Canada should have a standard approval. An authoritative body which is voluntary but which has on it at the same time a seal of office is very much worthwhile.

Senator Burchill: Is there not something similar today in Japan?

Dr. Wagner: I am not aware of that, senator. It may be so.

Senator Everett: I note that the head office of the Council will be in the national capital region. I am sure you expected a question along these lines. I would be interested to know what consideration went into the selection of the capital region as the head office location?

Dr. Wagner: As you say, senator, this is a question which comes up frequently in connection with the general thinking along the lines of why not put things elsewhere in the country. In this particular case it was felt that this kind of organization is truly national in some very special way inasmuch as it integrates the activities of industry and government in a very important manner. Because of the kind of work it does, the council is going to interface with at least six government departments on an active basis, and it was felt that it really would cause a major difficulty if it were not located in the capital region. That is to say it would affect its ability to do business effectively.

The Chairman: Let us take one point; supposing you have certain tests to be carried out to determine the fitness of certain materials for standardization, ordinarily where would you go for that?

Dr. Wagner: That is a very good point, Mr. Chairman. There is no requirement that certification laboratories which became associated with bodies which were part of either the

Standards Council or certified standards writing associations have to be in the capital region. Only the small corp of the head office.

The Chairman: But that was not my question. My question was where would you go to have this work done, some department of government?

Dr. Wagner: At the present time the Canadian Standards Association has extensive laboratories in Toronto, so that is one place we can go, and the pulp and paper association have facilities for doing these things also, and to some extent these are done in government laboratories.

Senator Everett: But would not present-day communications make it feasible to have the head office elsewhere?

The Chairman: Let us say, for instance, Winnipeg, senator?

Senator Everett: I think I would find that agreeable. What really concerns me is that everybody who sets up a new organization finds reasons to locate it in the national capital region, the concept apparently being that we can all assemble together, we are here and we can all be part of the assembly. It seems to me, and I do not want this to be a speech, that today's communications methods are being overlooked. You say, for example, that you will be working with six government departments. I do not see that it is necessary to meet for lunch with those departments or to be face to face all the time with them. In fact you are probably communicating with them electronically by phone or other methods even though you are in close proximity.

I have been wondering if any consideration has been given to this matter. It is a very important part of regional development and one that is seriously concerning people in the Maritimes and in the west. I know it is very convenient to concentrate the Civil Service in Ottawa, and I do not blame you. I would do the same thing myself. But I think I would give it some consideration. It seems to me that no consideration is given to the use of present-day communications as a means of decentralizing. With all due respect, I do not think that your reasoning for putting the council and all the supportive service in Ottawa is really too valid. On further examination it may well be valid, but the reasons you have given, with all respect, seem to me to be a little superficial.

The Chairman: I am sure you have noticed that in one clause of the bill it states that the council only has to meet in the national capital region once a year.

Senator Everett: It is not the meeting of the council that really concerns people who are concerned with regional development so much as the use of supportive services. Wherever you put the head office is where you are likely to employ the supportive services, and that is the big loss, not where the council itself meets because the council can meet almost anywhere.

Senator Molson: What are we talking about, Mr. Chairman, in terms of people? I notice the bill provides for an executive director and quite a number of people. Is this going to be a large empire or a small empire?

Dr. Wagner: We are expecting the staff will number about 30 or so.

The Chairman: Will they all be in Ottawa?

Dr. Wagner: The secretarial staff and the core staff will be here, yes.

Senator Molson: Have you any projected budget prepared for this? Have you contemplated how much it will cost the treasury if this bill becomes law?

Dr. Wagner: For staff?

Senator Molson: For staff, for space—for all the normal costs, communications, travelling, and so on. Has there been a budget prepared?

Dr. Wagner: We have prepared a budget in as much detail as we can for planning purposes at this stage. You understand, of course, that once an executive director were appointed, this would be one of his earlier responsibilities, but in round figures for the first year of operation we are expecting the budget to be about $190,000.

Mr. Douglas: The first year would be over $200,000—slightly over $200,000.

Dr. Wagner: Slightly over $200,000 for the first year and about $400,000 a year from then on.

Senator Carter: How did you arrive at the total number of personnel? You have 10, 6 and 41. I can understand the six members representing the six federal departments that are involved, and the 10 members, one from

each province, but how did you arrive at the 41? That seems to me an odd number.

Dr. Wagner: I see your point, senator. Going back in history some time, this piece of legislation which is in front of you is based on the discussions between a group of officials in the federal Government and a group of experts from the Canadian Standards Association, six from each side. They worked for a period of some time on what they called the proposal, and it is on this proposal that the legislation for the Standards Council bill is based.

One of their considerations during that period of time was who shall be on the council. As you can imagine, there are many people in the country who would have an interest. One of the things that was decided early was that it would be undesirable and too difficult to go to individual industries. There are simply too many in the country, and it would be an unweildy organization. So, the way to handle this was to go to associations, so it was based on this concept. But even reducing it this way, there are a very large number of associations, and even if one reviews these it still was not easy to come up with a number less than 41 as looking like being somewhat representative of industry and industry's interest in this field, on a national basis.

Senator Carter: So you did the best you could to represent as many organizations or enterprises or groups as possible, and that worked out to 41?

Dr. Wagner: This is a judgment on the basis of 12 people who have a lot of experience in this field.

Senator Carter: You mentioned in your presentation earlier about gaps. There were a number of voluntary agencies covering various areas and it was felt there was a variety of areas that constituted a gap where no one had taken any action. Could you give us a couple of examples of these areas? What I am most interested in is how you envisage this council working in those areas to develop voluntary standards among them.

Dr. Wagner: There have been a variety of areas that have been relatively well covered by standards—the electrical, particularly, and some lumber, particularly the lumber side of construction has been relatively well done; the gas and oil not so well; safety of toys and standards of manufacture. It is drawn to our attention by other associations in different groups that they feel they are not getting the kind of attention they want.

It is the hope, in setting up this kind of council, that by having all of the people who have expertise in doing this kind of thing, discussing what is required and how to go about it, attention will be focused in a much more articulate way on what is required to be done, and the program set up to do it. Do not forget that one will have here an executive director with a small staff of experts to keep this in front of the council, and particularly to keep this in front of the executive committee in order to set some momentum behind this kind of thing and get it done on a national basis.

Senator Carter: You have to rely on your powers of persuasion to get these people to do something.

Dr. Wagner: It is a voluntary organization.

Senator Carter: What happens in the case of exports, where in the countries to which the exports go the standards are lower than those in Canada? Do you insist on Canadian approved standards for those markets?

Dr. Wagner: If we are exporting to another country, then from our point of view we have somehow or other to meet the standards of that country, whatever they may be.

Senator Carter: Even if they are lower than the standards we insist upon for Canada?

Dr. Wagner: I do not see this as being a major worry for us. An area for worry for us as a country is the trading we do with highly industrialized countries where they might impose a standard, let us say, for reasons which we judge as being somewhat arbitrary, arbitrary in the sense it looks like it is not being set up for the sake of having a standard so much as for the sake of excluding some products.

Senator Carter: I was not thinking so much about that as from the manufacturer's point of view, in that he has to compete with other people, and if you insist on a higher standard than is required in the country where he wants to market his product, you are going to put him at a disadvantage compared to other competitors.

The Chairman: There is nothing compulsory here.

Dr. Wagner: This is not compulsory legislation.

The Chairman: As I understand your standard marks, they have a connotation and if you use them on a product they must conform to whatever the connotation is.

Dr. Wagner: That is quite right.

The Chairman: So if in export they want to put a certain Canadian standard mark on the product, the product must live up to that standard.

Senator Molson: It should be a "plus" or infer a quality even in the export field.

The Chairman: Yes.

Senator Phillips (Rigaud): Mr. Chairman, do you think that when we report the bill we should note with particular pleasure that the public authority is not trying to invade the private sector, but it is based on a voluntary basis? It is a rather unique bill and I am wondering if it should be noted historically.

The Chairman: Frankly, I was wondering, if it is a voluntary organization, what is the value of a special Act of Parliament to weld it together. Why is it still not feasible to have a voluntary organization and continue it on that basis?

Senator Benidickson: Mr. Chairman, this matter that is raised by Senator Phillips about the voluntary aspects of the bill arouses my curiosity. Among the witnesses here, is anyone familiar with a dispute that has gone on for some time about accreditation—you referred to timber—of timber processing? I think it is called the Boliden process, originating in Sweden. It is a method of dealing with green timber for telephone poles and other types of timber and structure that are imported in my part of northwestern Ontario under a voluntary system. Somewhere in the federal Government, through a voluntary committee dominated by the creosote people, the Boliden process has, in my opinion, not had fair access to accreditation. Are any of you familiar with that?

Dr. Wagner: Senator, I am not acquainted with that particular case, but I might say that that is one of the reasons why we thought it was important to have a co-ordinating organization, and to give to it the prestige of being set up by legislation.

We have heard of many cases of associations, manufacturers, and importers who want to deal in a particular product, and who feel that they are not getting a fair hearing. So, on the one hand you have existing private standardization organizations which are doing their work, and on the other hand you have other people who have contrary feelings. We do not want to interfere with the private work of the standards bodies, and yet we want to have a forum for dealing with these kinds of cases. We feel that such a forum as that envisaged by this bill will be very important for that particular purpose.

Senator Benidickson: My feeling in this particular instance has been that the committee of standards has been dominated by what I would call the old established setup, and that something new like the Boliden process was not given fair consideration by some body in the federal administration. In other words, some body in the federal administration accepted the word of this private committee which is dominated by the creosote people, and as a result the public did not get this cheaper method of preservation of timber.

The Chairman: Senator, you have brought it to public notice now. I would think that when Dr. Wagner gets back to his office his order of priority for this new organization will include the item to which you have referred right at the top of the list.

Senator Benidickson: That is the reason I mentioned it.

The Chairman: At least, if I were in his position that is what I would do. Are there any other questions?

Senator Everett: I should like to ask Dr. Wagner if the Government has any policy with respect to the introduction of the metric system into Canada, or if he can tell us what will be the likely timing of such introduction?

Dr. Wagner: As you know, senator, we have tabled a White Paper. It is now Government policy to consider what steps have to be taken to go to the metric system. In fact, the first step will be the establishment of a commission, and we are actively proceeding on

this front by looking for suitable people who might be involved in this kind of activity.

As you are no doubt aware, 72 per cent of Canada's export trade is with the United States, and so I think it would be unwise for us at this time to fix a date to convert to the metric system without knowing what the Americans will do, or at least before we have studied the effect that metric conversion will have on our trade with the United States.

On the other hand, the other 28 per cent of our trade very soon is going to be entirely with metric countries. So, the first important step, as we see it now—although this will be something to which the metric commission itself will be expected to address itself in a general way—is to ensure that we know where we are today. We shall have to examine the whole problem in a national context, and to identify possible areas where we might go metric now without prejudice to our trade, and one can think of areas like that of education. Certain industries are already reasonably well converted to the metric system. Certain parts of the electronic industry are virtually all metric; the pharmaceutical industry is virtually all metric; and the photographic industry is virtually all metric. Certain parts of the construction industry are anxious to go metric, and one should look at that in order to see whether it is possible to do it independently of the United States. One has to examine this in a context of our trade relations with them. This is the stage at which we are now. Incidentally, the Standards Council will have an important responsibility in that regard.

Senator Molson: Mr. Chairman, clause 18 of the bill provides:

> The Council shall be deemed to be a charitable organization...

I am just wondering why?

Dr. Wagner: I think I am going to let Mr. Douglas answer that, if you do not mind, senator.

Mr. H. C. Douglas, Director (Policy), Office of Science and Technology, Department of Industry, Trade and Commerce: Mr. Chairman, as indicated in the section which provides for the council to be financed by moneys voted by Parliament, we do not anticipate, at least in the near future, that the council will have any sources of revenue. However, it is possible that somewhere down the road the council may develop sources of revenue. The British Standards Institution, for example, receives about one-half of its total revenues from government, but the balance is provided by industry. Of course, the Canadian Standards Association is almost entirely dependent upon contributions from industry, and upon revenues received from some of its testing services and the use of its mark.

It is in contemplation that at some time in the future the council may receive revenues from other sources that this provision was put in the bill. If it does receive a donation then the donation will be deductible for tax purposes by the donor.

Senator Molson: I do not altogether accept the principle of the thing, because if industry subscribes to a standards council then surely the subscription is a legitimate expense on the part of the industry. Therefore, the Standards Council does not need the tax connotation of a charitable organization. I do not quite see why an individual should be making donations to a Standards Council, and I do not think that clause is needed, or is even useful.

The Chairman: The law clerk tells me that the same provision was incorporated in another bill.

Mr. E. Russell Hopkins, Law Clerk and Parliamentary Counsel: Yes, the bill setting up the International Development Research Centre.

The Chairman: I do not think the bill was before this committee.

Mr. Hopkins: No, it was before the Standing Senate Committee on Foreign Affairs.

The Chairman: I am not sure that that was the same type of bill. An international research council and a standards council are not the same thing. There would be any number of occasions upon which there would be substantial contributions from the private sector for research, and that is rather desirable, but I question whether the Standards Council should receive donations from other than industry, and if industry makes a donation then that donation is properly deductible.

It occurred to me that certain donations of gifts to Her Majesty in the Right of Canada are free of any tax, and we do not need such a provision as this in order to have that apply. This is going to be of the nature of a

crown corporation, and I am sure there could be a provision in the bill to the effect that the contributions to this council shall be construed as gifts to Her Majesty in the Right of Canada.

Senator Everett: Mr. Chairman, there is a similar provision in the National Museums Act. The organization there is designated a charitable organization so that gifts or bequests can be directly to it.

The Chairman: That type of provision would have been more appropriate than simply making it a charitable organization under section 62 of the Income Tax Act.

Senator Everett: That is quite right.

Mr. Douglas: Mr. Chairman, the reason for covering this point explicitly is that the council is not an agency of Her Majesty nor a crown corporation. If it were a crown corporation in the true sense then, as you indicate, there would be no requirement for this provision.

The Chairman: I was only proceeding on the basis that Dr. Wagner told us at the outset that this is in the nature of a crown corporation.

Senator Molson: I thought I had seen something to that effect in the bill, but there is no allusion to it.

Dr. Wagner: I apologize for that, Mr. Chairman. The council is being set up and it is not an agency of Her Majesty, specifically to make it as autonomous as possible.

Senator Benidickson: Mr. Chairman, this again raises the point I had in mind. I am no expert and do not purport for one moment to advise the people that will be in charge of the Standards Council of Canada as to the merits of one type of timber processing as against another. However, I would like them to investigate this point in the voluntary investigation that is taking place on the standards committees of the various industries, including the one that I have mentioned.

If contributions are to be made, will there be a bias or prejudice in favour of those established industries which make a contribution and oppose something new and venturesome such as the type of situation that I have described with respect to timber processing?

Dr. Wagner: Mr. Senator, the council will be a body with a very wide representation. What is more, it is not going to be represented by individual industries, but by people who represent industry as sectors in a very broad way. I would certainly hope that such a group would be impartial and that people with complaints would in fact find that they had a forum for hearing.

The Chairman: Senator Molson, clause 15 of the bill specifically provides that the council is not an agent of Her Majesty.

Senator Molson: Yes; thank you, Mr. Chairman.

Senator Phillips (Rigaud): Mr. Chairman, while supporting this bill, I would like to report what I consider to be an undesirable feature. He who pays the piper calls the tune and in the final analysis, even though we have a bill in the concept formulated to be enacted as a voluntary association with the cost of administration paid by Parliament, we have an essential contradiction. It will be a voluntary association, but by the same token the total cost of administration will be paid by the federal Government. In the process inconsistency will arise in the administration.

I consider it to be a grave mistake to have a voluntary association in concept and at the same time have the cost of administration paid by the public purse. It is a contradiction in terms.

The Chairman: I thought you were going further; the contradiction might be in having a voluntary organization receiving its financial support from the Government and as against that accepting donations or contributions from private industry. It might be suggested that in order to accomplish what private industry wants, the Government is paying part of the shot and if this is so much for the benefit of private industry maybe it should be financed in some way by private industry.

Senator Phillips (Rigaud): I think your point is broader than mine and in a sense ancillary, but there is something basically wrong in an organization being voluntary and at the same time being paid for by the public purse.

Dr. Wagner: I see the point you are making, senator. Perhaps I could say a few words in that respect. The idea of voluntary standards in industry in my opinion is a good one. I do not see why we should attempt at this point in time to compel industry adhere to a set of mandatory standards. Therefore

the concept of voluntary standards is retained but the problem we are beginning to see is that there are gaps. It is not developed enough; we should be doing more work. If we see this as national, then I think we have to pay for it and still keep it on a voluntary basis.

Let me name one important individual who is affected by all of this, namely the consumer. How does the consumer become represented in a voluntary organization unless his Government represents him in this way? This is one of the reasons for setting it up.

You are saying that there is an inconsistency in having someone pay for something and then say we are not going to influence you. That is a little hard to believe and I can understand that statement. At the same time, we now have at least two other organizations, the Economic Council of Canada and the Science Council of Canada, both of which are set up, not identically to the Standards Council, but conceptually in a similar way. I think you would agree that they are independent of Government, and we visualize the Standards Council as being autonomous.

Senator Phillips (Rigaud): I think you are being fair.

Senator Everett: Mr. Chairman, I think the bill is a good one. These voluntary aspects are something that I think should be striven for and I think the council will do a useful job.

I would like to record, however, that I think greater consideration could and should have been given to the location of the head office of the council.

The Chairman: You mean decentralization.

Senator Everett: Decentralization.

Senator Phillips (Rigaud): Preferably in Manitoba.

Senator Everett: No; I would be happy with Montreal.

The Chairman: Do you mean Manitoba is not as ready as Montreal?

Are you ready for the question?

Hon. Senators: Yes.

The Chairman: Shall I report the bill without amendment?

Hon. Senators: Agreed.

The committee adjourned.

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1969-70

THE SENATE OF CANADA

STANDING SENATE COMMITTEE
ON

Banking, Trade and Commerce

The Honourable SALTER A. HAYDEN, *Chairman*

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OF PROCEEDINGS
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